S T A T E O F M I C H I G A N

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of natural gas, and for miscellaneous accounting authority.	)	Case No. U-15985

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on April 2, 2010.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before April 16, 2010, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before April 26, 2010. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Mark E. Cummins

Digitally signed by Mark E. Cummins
DN: cn=Mark E. Cummins, c=US, email=mcummi@michigan.gov
Date: 2010.03.31 13:53:51 -04'00'

Mark E. Cummins
Administrative Law Judge

April 2, 2010
Lansing, Michigan
dmp

S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of natural gas, and for miscellaneous accounting authority.	)))))))	Case No. U-15985

PROPOSAL FOR DECISION

Issued and Served: April 2, 2010

TABLE OF CONTENTS

S T A T E O F M I C H I G A N

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES

FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of natural gas, and for miscellaneous accounting authority.	)))))))	Case No. U-15985

PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

Michigan Consolidated Gas Company (Mich Con or the Company), a subsidiary of DTE Energy Company (DTE), is a public utility engaged in the business of purchasing, storing, transporting, distributing, and selling natural gas to over a million customers throughout the state of Michigan. Mich Con's system is an integrated and interconnected entity that is operated as a single utility system, in which the same rates and tariff provisions apply to all customers within each rate class, regardless of location. The Company presently serves its retail transportation, storage, and distribution customers under rates, terms, and conditions established by the Commission's April 28 and July 19, 2005 orders in consolidated Cases Nos. U-13898 and U-13899, as well as pursuant to several special contracts previously approved by the Commission. In addition, the Commission has also authorized--through various orders--the recovery of certain additional costs as set forth in the tariffs on file with the Commission, including gas cost recovery (GCR) factors.

On June 9, 2009, Mich Con filed an application, with supporting testimony and exhibits, seeking authority to increase its rates by approximately $193 million annually (based on cost increases computed through application of a projected 2010 test year). According to its application, Mich Con also sought Commission authority to: (1) continue the use of its Uncollectible Expense True-up Mechanism [UETM], albeit with certain modifications; (2) implement a Revenue Decoupling Mechanism [RDM]; (3) establish a Lost and Unaccounted for Gas and Company Use Expense True-up Mechanism [LGTM]; (4) recover a portion of the control premium that DTE paid to acquire MCN Energy Group, Inc., [MCN] which was Mich Con's owner; (5) increase its return on common equity from 11.00% to 11.25%, or even to 11.50% if the proposed RDM is rejected; and (6) either continue or implement various accounting- and income tax-related activities. Finally, Mich Con sought express confirmation that the Company's filing satisfied the Commission's directives--as set forth in Cases Nos. U-13898 and U-13899, as well as Case No. U-15479, respectively--to account for the special contract with Dearborn Industrial Generation, LLC, (DIG) as a separate rate class in all future cost of service studies, and to propose a low-income energy efficiency funding (LIEEF) program as part of this general rate case filing.

Pursuant to due notice, a prehearing conference was held in this proceeding on July 14, 2009 before Administrative Law Judge Mark E. Cummins (ALJ). In addition to Mich Con and the Commission Staff (Staff), several potential intervenors also filed appearances and participated at the prehearing. Intervention was granted on that date to the following parties, grouped collectively as appropriate: Attorney General Michael A. Cox (Attorney General); the Association of Businesses Advocating Tariff Equity (ABATE); the Michigan Community Action Agency Association (MCAAA); the Utility Workers Union of America, AFL-CIO, Local 223 (Local 223); the National Energy Marketers Association; Interstate Gas Supply; HighMount Midwest Energy, LLC, HighMount Exploration and Production Michigan, LLC, Breitburn Operating L.P., Muskegon Development Company,[1] and O.I.L. Energy Corporation (collectively, the Producers); and Atlas Gas & Oil Company, LLC (Atlas).[2] On July 22 and September 21, 2009, respectively, the ALJ also granted late petitions to intervene filed on behalf of the Residential Ratepayer Consortium (RRC) and Constellation NewEnergy-Gas Division, LLC (Constellation).

This is Mich Con's first general rate case since Act 286 of 2008, MCL 460.6a, et seq., (Act 286) took effect on October 6, 2008. As noted by the Commission on page 3 of its May 26, 2009 order in Cases Nos. U-15768 and U-15751, "Act 286 established extremely short timeframes for concluding rate cases" such as this. For example, Section 6a(1) of Act 286 provides that if the Commission has not issued an order within 180 days of the filing of a complete application for a rate change, the utility may self-implement any portion of its proposed change through "equal percentage increases or decreases applied to all base rates" (although, if the utility's proposal is based upon a projected test year, self-implementation shall not occur prior to the start of the projected

[1] On December 7, 2009, the ALJ granted Muskegon Development Company's October 16, 2009 Motion to Withdraw.

[2] On October 16, 2009, Atlas joined with the Producers in this proceeding, and counsel for the Producers filed a statement of consolidation on October 22, 2009. Thus, for purposes of this Proposal for Decision (PFD), these joint participants will be referred to collectively as "Atlas."

12-month period). MCL 460.6a(1). Moreover, Section 6a(3) requires the Commission to issue its final order within 12 months following receipt of a complete rate case filing, lest the application be considered approved. See, MCL 460.6a(3). Much to their credit, the parties present at the prehearing conference were able to develop a consensus schedule that would allow the Commission to meet the inordinately short deadlines imposed by Act 286.

On October 22, 2009, ABATE filed a motion seeking to strike all testimony and exhibits included with Mich Con's application supporting the Company's proposal to recover a portion of the control premium paid by DTE. In response to that motion, Mich Con filed revised testimony and exhibits on November 6, 2009, from which all references to its request to recover control premium-related costs were removed.

Pursuant to the previously-established schedule, an evidentiary hearing was held on December 7, 2009 concerning the Company's proposed self-implementation of its requested rate increase. In the course of that evidentiary hearing, the testimony of Gerardo Norcia, Mich Con's President and Chief Operating Officer, was bound into the record and each of his three accompanying exhibits was received into evidence. In his testimony and exhibits, Mr. Norcia recommended self-implementation of a rate increase in the amount of $170 million annually, and supported using an alternative rate design instead of the statutory equal-percentage default rate design. See, 3 Tr 63-75; Exhibits A-20, A-21, and A-22. Although none of the other parties cross-examined Mr. Norcia or offered evidence of their own regarding self-implementation, both the Staff and ABATE filed--in advance of the December 7, 2009 hearing--responses to Mich Con's proposal. In the absence of a Commission order directing it to do otherwise, on January 1, 2010, the Company self-implemented a $170 million increase in its gas rates. Moreover, and pursuant to MCL 460.6a(1), that increase was applied on an equal percentage basis for all customer classes.[3]

Evidentiary hearings concerning the remainder of Mich Con's general rate case took place on January 11, 12, and 14, 2010. The Company presented the testimony and exhibits of an additional 22 witnesses, and the Staff offered testimony and exhibits from 13 witnesses. Also, Constellation, Local 223, Atlas, the RRC, MCAAA, ABATE, and the Attorney General offered testimony and exhibits from one witness each. When combined with the evidence received during the December 7, 2009 hearing, the entire record consists of 1,866 pages of transcript and 112 exhibits, each of which was received into evidence (and several of which are comprised of multiple schedules).

As in most cases of this nature, a large amount of testimony and argument has been presented with regard to issues that are both numerous and complex. In addition to the typical issues arising in general rate cases, a significant portion of the record assembled in this proceeding deals with tracking or decoupling mechanisms--such as the UETM, LGTM, and RDM--proposed by Mich Con, Local 223's request to establish an employee training trust fund, various parties' requests to immediately fund a LIEEF program, Atlas' proposed conversion of the Saginaw Bay Pipeline (SBPL) from a wholly-owned subsidiary to a direct Mich Con asset, MCAAA's request to begin the process of having the Company revise its underlying inventory accounting methodology, and Constellation's plan for allowing the use of "pooling" as it applies to gas

[3] On January 8, 2010, ABATE filed a motion seeking a temporary order regarding self-implementation, for which it requested immediate consideration. According to ABATE, Mich Con's use of an equal percentage rate design for the self-implemented rate increase was unjust and unreasonable. On February 8, 2010, the Commission issued an order denying that motion.

nominations and storage usage. Despite the number and complexity of these various concerns, Act 286 requires (as noted earlier) the issuance of a Commission decision within 12 months after the application's filing. Thus, in the interest of issuing this PFD in a timely manner, not all of the material presented in this case will be expressly discussed. The various parties' summaries of the evidence and arguments in support of their respective positions are fully set forth in their pleadings, briefs, and reply briefs, and the underlying basis for the same can be found in the evidentiary record. Thus, although the ALJ has considered the entire record in arriving at the findings and conclusions expressed below, only those arguments, testimony, and exhibits that are necessary for a reasoned analysis of the disputed issues will be specifically addressed in the PFD.

II.

TEST YEAR

In every general rate case, the initial task is the selection of an appropriate test year. Essentially, this task is comprised of two components.

First, a decision must be made regarding the 12-month period to use in setting the utility's new rates. In this proceeding, both Mich Con and the Staff proposed using the calendar year ending December 31, 2010 for that purpose, and none of the other parties objected. Based on this lack of disagreement, the ALJ recommends adopting that 12-month period for use in this case.

Second, a determination must be made regarding how to best establish values for the various levels of revenue, expenses, rate base, and capital structure used in the rate-setting formula. These values may consist of historical, future, or a combination of historical and future data. A historical test year uses actual operating data that, once audited, is generally adjusted for known and measurable changes. A future test year (frequently referred to as a projected test year) uses projections to determine the levels of revenue, expenses, rate base, and capital structure for a future period of time.

Although parties often clash over what type of test year is most appropriate in a given case, the Commission has generally expressed a preference for using historical, as opposed to purely projected, data. See, i.e., the Commission's November 7, 2002 order in Case No. U-13000, at p. 13. Nevertheless, Section 6a(1) of Act 286 states that a utility may "use projected costs and revenues for a future consecutive 12-month period" to develop its requested rates and charges. See, MCL 460a(1). This statutory provision has altered the debate somewhat by specifically indicating that Michigan's regulated gas and electric utilities have the right to base their general rate case filings exclusively upon projections of anticipated activities and their related expenses, should they so desire. What it does not do, however, is demand that either the parties or the Commission blindly accept any and all numbers springing from a utility's projections of future actions and the potential costs arising from them.

The Commission recently acknowledged this fact in its January 11, 2010 order in Cases Nos. U-15768 and U-15751 (the January 11 order), where it stated that:

> In a case where a utility decides to base its filing on a fully projected test year, the utility bears the burden to substantiate its projections. Given the time constraints under Act 286, all evidence (or sources of evidence) in support of the company's projections should be included in the company's initial filing. If the Staff or intervenors find insufficient support for some of the utility's projections, they may endeavor to validate the company's projections through discovery and audit requests. If the utility cannot or will not provide sufficient support for a particular revenue or expense item

> (particularly for an item that substantially deviates from the historical data) the Staff, intervenors, or the Commission may choose an alternative method for determining the projection.

January 11 order, p. 9.

Apparently both anticipating (in its pre-filed testimony) and recognizing (as expressed in its post-hearing briefs) the Commission's recently-expressed views concerning what currently constitutes the preferred approach, Mich Con contends that it refrained from sponsoring a fully-projected test year. Instead, the Company explains, it used actual financial results from the historical test year ended December 31, 2008 "as a point of departure, and then normalized and adjusted those results for inflation and other known and measurable changes" to arrive at what it projected to be a $192.3 million revenue deficiency. Mich Con's initial brief, p. 17. That figure was subsequently increased slightly to $192,572,000.[4] See, Mich Con's reply brief, p. 2, as well as Attachments A and E to that brief.

The Staff offered a fairly similar test year proposal. Specifically, it began with "the Company's December 31, 2008 financial information in the audited 2008 P-521 filing," adjusted many of the historical figures contained therein (albeit using its own recommended inflation factors) to bring them to 2010 levels, and included some projections that were "not tied to historical information" in areas where it felt that the application of inflation factors alone would result in an "unreasonable" result. Staff's initial brief, p. 5. Despite these slight differences from the Company's own approach, neither Mich Con's witnesses on this issue nor the utility's briefs take issue with the Staff's general approach.

[4] In contrast, the Staff's direct case supports a revenue deficiency in the amount of $144,622,000, while the Attorney General contends that only $104,100,000 in rate relief is justified. See, Staff's reply brief, at p. 1; Attorney General's initial brief, p. 1.

We are thus left in a situation where the only two parties to specifically weigh in on the matter both advocate use of a largely projected 2010 test year based on year-end 2008 data. Of these two proposals, the Staff's appears to be preferable due to the fact that it relies on financial data that was actually audited by Mich Con's independent certified public accountants. As such, the ALJ recommends that the Commission adopt, as a starting point, the specific test year methodology proposed by the Staff.

III.

RATE BASE

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements.

In this case, Mich Con originally proposed setting its total rate base for the 2010 test year at $2,361,107,000. This figure consists of $3,724,169,000 in total utility plant less a depreciation reserve of $2,058,507,000 (which together result in a net utility plant figure of $1,665,662,000), plus a working capital allowance of $695,444,000. See, Exhibit A-9, Schedule B1 (Revised). The Staff, on the other hand, proposed setting Mich Con's total rate base figure at $2,354,528,000. The Staff's proposal begins with $3,671,669,000 in total utility plant, reduces that figure by $2,002,311,000 in depreciation (for a net utility plant of $1,669,358,000), and then adds $685,170,000 in projected working capital requirements. See, Exhibit S-2, Schedule B-1.

Although pointing out that it and the Staff "took different paths to arrive at utility rate base," Mich Con now recommends starting with the Staff's figure and making two significant adjustments, as well as one minor correction. Mich Con's initial brief, p. 17.

The first is a proposed adjustment to net utility plant arising from Atlas' proposal to transfer ownership of the SBPL to the Company, while the second is a suggested increase in working capital to reflect costs that the utility expects to incur from future manufactured gas plant (MGP) remediation efforts. The minor correction concerns the effect that deleting the control premium issue may have had on working capital. For his part, the Attorney General takes issue with the proposed level of both routine and non-routine capital expenditures, as well as perceived expenditures arising from the wide-scale implementation of Mich Con's advanced metering infrastructure (AMI) program. See, Attorney General's initial brief, pp. 17-18 and 20-22. Each of these issues is addressed in the following discussion of net utility plant and working capital.

A. Net Utility Plant

In arriving at its suggested level of net utility plant, the Staff examined both Mich Con's proposal and its underlying calculations, beginning with historical, year-end 2008 figures and ending with calendar year 2010 projections. As part of this process, the Staff compared the 2009 utility plant and depreciation projections included in the Company's filing to actual events occurring over the course of that year. According to Kevin S. Krause, an auditor within the Revenue Requirements Section of the Staff's Regulated Energy Division, actual asset retirements for 2009 "were running significantly higher than the Company's projections." 6 Tr 1715. Mr. Krause went on to note that this was due in large part to Mich Con's recent removal of the Noble Building from plant in service. Id. As reflected on lines 4 through 6 of Exhibit S-2, Schedule B-1, factoring the effects of these higher-than-expected retirements into the projections for Mich Con's plant in service and depreciation reserve gives rise to the Staff's net utility plant figure of $1,669,358,000.

As noted above, both Mich Con and the Attorney General have raised issues regarding the level of net utility plant that should be adopted for use in this rate case proceeding. The first of these issues concerns Mich Con's proposed treatment of the SBPL for ratemaking purposes, while the other two arise from the Attorney General's belief that an excessive amount of capital expenditures and AIM program costs are included in the Staff's net utility plant figure.

1. SBPL (Approval and Ratemaking Effects)

Atlas intervened in this proceeding to advance a single issue, namely its request to have the Commission either order or (assuming Mich Con could be convinced of the benefits of doing so voluntarily) approve the transfer of the SBPL from a wholly-owned Mich Con subsidiary to Mich Con itself. The underlying desire for this change appears to be the fact that, as the primary transporters of gas in the Alpena/Petoskey region under Mich Con's rate schedules TOS-I and TOS-F, the parties comprising Atlas pay most of the $3.3 million annually billed in that region for off-system transportation service and related gas-in-kind charges. See, Atlas' initial brief, pp. 3-4. According to Atlas' witness, Carl J. Croskey, the fact that it is already paying SBPL to transport this gas (which, he states, moves through Mich Con's transmission system from the Alpena area to West Branch, where it is handed off to the utility's "sister company"--SBPL--and transported to Kalkaska, at which point it is returned to Mich Con's system) means that the fees imposed by the Company constitute an "unjust and unreasonable" double-charge. 5 Tr 598. Mr. Croskey went on to state that having the SBPL transferred to

Mich Con and included in the utility's existing pipeline system would mean that each of these producers "would no longer be treated as an off-system transporter," while concurrently providing benefits to other sales and transportation customers by integrating "remote pipeline segments" like those in the Alpena area into the utility's overall transmission system. 5 Tr 589 and 593.

Notwithstanding its initial resistance to converting the SBPL from a wholly-owned subsidiary to a direct utility asset,[5] Mich Con now supports this proposal, albeit only if the conversion "is done consistent with the operational and financial issues" set forth in rebuttal testimony provided by two of its witnesses. Mich Con's initial brief, p. 18. As for operational issues, Mich Con's Director of Gas Control, Andrew M. Springstead, testified that incorporating the SBPL into the Company's transmission system would require (1) adding "an odorization facility at the existing Saginaw Bay to Alpena meter station," and (2) either treating or redirecting "small volumes of production gas" currently transported by the SBPL "to ensure that the gas stream after transfer meets Mich Con's gas quality specifications for heavy hydrocarbons, hydrocarbon dew point, and carbon dioxide content." 5 Tr 1384. As for the financial issues, Peter M. Rynearson, Controller for both Mich Con and other DTE gas subsidiaries, stated in his rebuttal that the Commission's final order in this case would need to "explicitly authorize Mich Con to transfer SBPL at its construction cost and corresponding accumulated depreciation." 4 Tr 438. According to him, doing so would necessitate increasing the Company's 2010 test year rate base by $11,120,000. See, 4 Tr 437 and Exhibit A-40, line 4.

[5] During the July 14, 2009 prehearing conference, Mich Con argued against granting Atlas' Petition to Intervene on the grounds that its demand to add the SBPL to the Company's transmission system (1) was beyond the scope of the proceeding, (2) created issues regarding adequate notice to the public, and (3) sought relief that was beyond the Commission's power to grant. See, 1 Tr 23-27.

Atlas and Mich Con assert that the benefits of adding the SBPL to Mich Con's system outweigh the costs. Specifically, the Company points to Mr. Springstead's testimony that short- and long-term operational benefits would include:

> [providing] an additional source of supply for the Alpena-Gaylord system, removing the dependence on local production (which is declining and is expected to continue to do so), limiting reliance on the Alpena compressor station to meet peak winter demands from Alpena-Gaylord markets, and potentially connecting into the Gaylord pipeline to allow better balancing of the system and provide additional alternatives to Gaylord area markets. Because SBPL crosses [Great Lakes Gas Transmission Company's] pipeline system, there is also the potential for a future interconnect for added continuity of service.

5 Tr 1387. As for non-operational benefits arising from the proposed asset transfer, the Company also cites testimony from Mr. Springstead stating that:

> Mich Con would realize a decrease in transportation fees paid to third party pipelines in the form of no further payments being made to SBPL ($800,000 annual cost). Annual fuel and O&M savings could be generated from limiting reliance on running the Alpena compressor station to meet peak winter demands from Alpena-Gaylord markets. Mich Con would be able to use this transmission asset to provide utility service to additional areas not currently serviced by Mich Con, but within Mich Con's service territory (larger customer base). Finally, Mich Con would be able to provide the transportation and storage services through a better integrated system.

5 Tr 1388. According to Mich Con, the above-cited benefits could be obtained for a mere $4,351,000 increase to its annual revenue requirement.[6] Mich Con's reply brief, p. 102, citing Attachment C.

[6] In computing that figure, Mich Con added the $2,380,000 incremental cost of service arising from including the SPBL in its rate base to the $2,265,000 reduction in annual transportation revenue and $516,000 reduction in annual gas-in-kind payments received from Atlas and others, and then reduced that total by the $810,000 in annual transportation payments that the utility would no longer have to pay to the Saginaw Bay Pipeline Company. It should be noted, however, that Mich Con's currently proposed figure differs--at least slightly--from that computed by the Company's primary witness regarding the computation of its overall revenue deficiency, Margaret A. Suchta, who testified that the annual revenue requirement would rise by $4,789,000. See, 5 Tr 1348-1349.

In contrast, the Attorney General challenges Atlas' proposal on several grounds. First, he argues (as Mich Con did at the July 14, 2009 prehearing) that the Commission "lack[s] the power to order the asset transfer," and that adding this matter--with its price tag of over $4 million annually--to the Company's initial rate request creates a significant "notice problem." Attorney General's initial brief, p. 27. Second, he contends that because nothing in the record indicates that the asset transfer advocated by Atlas has actually occurred, "it would be premature for the Commission to include the asset in rate base." Id. Third, the Attorney General asserts that "the basic reasoning for Atlas' proposal" (namely, its belief that it is paying twice for the same transportation service) is faulty, in that it is "customary in the natural gas industry for producers to pay a fee for transportation of gas to a gathering pipeline" and for either those producers or their customers to then "pay a transmission company for transportation to a gas utility or end user market." Id. Fourth and finally, he claims that the potential benefits identified by Messrs. Croskey and Springstead are too "vague and unsupported" to justify adding the SBPL to Mich Con's system.[7] Id., at 28. The Attorney General therefore concludes that the Commission should refrain from including the SBPL in rate base unless and until

---

[7] This is particularly true, the Attorney General argues, in light of Mr. Springstead's testimony to the effect that:

> If SBPL were integrated into the Mich Con system, each production area would require one of the following:
>
> 1) connection to alternate transportation facilities for which the gas meets such pipeline's gas quality specifications,
> 2) construction of processing facilities to meet gas quality specifications as well as additional monitoring equipment to protect the Mich Con system and verify the gas quality on a continuous basis, or
> 3) shutting in the production.

See, Attorney General's initial brief, p. 28 (citing 5 Tr 1385).

Mich Con makes a more convincing case for why its ratepayers should absorb the annual costs that would arise from transferring ownership of this "underperforming asset" to the utility. Id.

For its part, MCAAA contends that Atlas' proposal should be deferred for a more thorough review in Mich Con's next general rate case. In support of this contention, MCAAA asserts as follows: (1) based on Mr. Croskey's statement that the SBPL is owned by Mich Con's wholly-owned affiliate, the Saginaw Bay Pipeline Company, the proposed transfer "appears to be an affiliated transaction wherein the protections of arms-length bargaining are absent;"[8] (2) while this transfer will increase the utility's revenue requirement, due in part to lost fees from Atlas and others, "there appears to be no real opportunity of other revenues being generated by the facilities;" (3) the alleged ratepayer benefits arising from the transaction "are wholly theoretical and speculative, and are largely unexplained," thus making it essential that the Commission either demand a more detailed analysis of the asserted benefits or impose specific conditions on the asset transfer to ensure that they are actually realized; and (4) approving the proposed asset transfer and immediately recognizing its ratemaking effects based on the record assembled in this case could "establish extremely bad or precipitous precedent" by engendering the transfer of "additional, questionable, or uneconomic assets" to Mich Con from other affiliates. MCAAA's initial brief, pp. 22-23.

In addition to the heightened review that could be afforded this issue in the utility's next rate case, MCAAA asserts that consideration of the asset transfer could

[8] The Attorney General apparently finds this all the more disconcerting in light of the fact that Atlas "purchased the assets of DTE Gas & Oil in 2007," leading him to wonder whether "it too may be an affiliate or recent affiliate of DTE or Mich Con." Attorney General's initial brief, p. 22 (citing 5 Tr 588).

benefit from a Staff audit and report regarding Atlas' proposal. Moreover, MCAAA claims that:

> [A]ny such transaction, if it were ever approved, should require the assets to be transferred at the LESSER of book value or market value, with the market value assessed based upon an objective analysis of the value of the stream of actual revenues that would be generated by the facilities on and after [the date] that any transfer is made.

Id., p. 23. According to MCAAA, an analysis of that type may well establish that the assets actually have little or no value to the utility, and that they should not be added to Mich Con's rate base or otherwise recovered from its ratepayers.

The Staff agrees "in concept" with Atlas' proposal (due to its potential for increasing supply reliability and security, expanding gas purchasing options and competition, and spurring "future gas production" in northeast Michigan). Staff's reply brief, pp. 41-42. Nevertheless, it goes on to note that the record lacks sufficient information to justify including all of the costs arising from the proposed asset transfer in the Company's rates. As a result, the Staff recommends deferring this issue to the utility's next general rate case, and directing Mich Con to "file a thorough cost benefit analysis of the [SBPL] transfer quantifying the associated costs." Id., p. 42.

The ALJ agrees with the overall conclusion reached by the Attorney General, MCAAA, and the Staff, namely that the Commission should not--at least in the context of the present case--include the SBPL as part of Mich Con's net utility plant. While it may make sense to eventually incorporate the SBPL into the Company's transmission system, the record fails to adequately support the increased revenue requirement that would result from adopting the joint Atlas/Mich Con proposal at this time.

As Atlas correctly noted, it had "the burden of supporting its request for affirmative relief with an adequate factual record." Atlas reply brief, p. 5. Here, while it and the Company did offer evidence supporting the proposition that adding this asset to Mich Con's system may ultimately provide both operational- and non-operational benefits to the utility, these parties did not conclusively show that the utility's sales and transportation customers (at least those other than Atlas, et al.) would receive overall benefits in excess of the costs arising from transferring the SBPL to Mich Con. This conclusion is based on the following three factors.

First and foremost, no comprehensive cost/benefit analysis has been provided with regard to this proposal. Although Mich Con concedes that incorporating the SBPL into its transmission system would require construction of an odorization facility adjacent to the Saginaw Bay/Alpena meter station, and although logic dictates that additional costs would need to be incurred to obtain all of the operational- and non-operational benefits described by Mr. Springstead,[9] few--if any--of those construction costs appear to have been specifically included in the utility's computations. <u>See</u>, <u>i.e</u>., Exhibit A-30.

Second, Mich Con's support for Atlas' initial proposal is based on the assumption that the Commission would allow Mich Con to transfer the SBPL at its construction cost, as opposed to the pipeline's book value. In this regard, Mr. Rynearson testified that the book value of the SBPL "reflects an accounting impairment[10] . . . recognized as a

---

[9] These costs would include those arising from constructing some sort of interconnection with both the Gaylord Pipeline and Great Lakes' nearby transmission system.

reduction of the gross plant of [the] SBPL," which--in turn--results in an understatement of the facility's original cost. 4 Tr 438. While Mich Con may ultimately be correct in its assumption regarding how the Commission would value this potential utility asset, the Company provides little (at least beyond a brief citation to the Uniform System of Accounts) in the way of support for its belief. This is particularly troubling in light of the fact that the proposed asset transfer would seem to constitute an affiliate transaction, thus engendering a higher degree of scrutiny than a run-of-the-mill transaction.

Third, testimony provided by Mich Con's witness regarding the operational effect that Atlas' proposal would have on other users of the Company's transmission system indicates that producers in Michigan's northeastern lower peninsula may be adversely affected by incorporating the SBPL into that system. Specifically, and as noted in part by footnote 7 of this PFD, Mr. Springstead testified that producers in that area would be required to either (1) find some other pipeline to transport their gas, (2) build CO_2-removal or other treatment facilities to ensure that the gas entering the utility's system meets the pipeline's gas quality specifications, or (3) fully shut in their gas production. See, 5 Tr 1385-1386. Although noting that Atlas "stated that all of the impacted producers have agreed to either re-route their gas to another transporter and/or have their gas treated at an existing facility at no cost to Mich Con," Mr. Springstead went on

---

[10] Mr. Rynearson described the basis for that accounting impairment as follows:

> During the third quarter of 1998, it was determined that Antrim gas could no longer continue to flow through the [SBPL] untreated, and therefore had to be routed north on the Lovell's pipeline into the Antrim Expansion Pipeline for CO_2 treatment. In November 1998, an accounting impairment of $15.800 million was recorded at Saginaw Bay Area Limited Partnership based on an analysis of discounted cash flows that indicated a significantly lower fair market value compared to net plant.

4 Tr 439.

to concede that the Company itself "has not had any discussions with these producers about how this issue would be addressed." Id., at 1386.

For the three reasons expressed above, the ALJ finds that an insufficient evidentiary basis exists for approving the potential transfer of the SBPL to Mich Con, including that asset in rate base, and increasing the Company's revenue requirement to reflect the incorporation of this asset into its transmission system, at least at this point in time. The ALJ therefore recommends that the Commission reject the joint Atlas/Mich Con proposal and, instead, direct Mich Con to provide a thorough cost/benefit analysis concerning the proposed SBPL transfer (including a full analysis of all associated costs) as part of its next general rate case filing.

2. Miscellaneous Capital Expenditures

Mich Con included, as part of its 2010 projected test year costs, approximately $157 million of capital expenditures, excluding all potential expenses arising from new market attachments. According to Todd F. Persells, the utility's Director of Asset Management and Engineering, this projected figure consists of $95.9 million in "routine construction" (which was based on the Company's five-year average for the period 2004 through 2008, plus inflation), and $61.1 million worth of spending on "Other Capital Projects."[11] See, 4 Tr 506-508, and Exhibit A-9, Schedule B6.1. The Company contends that its proposed level of routine capital expenditures for 2010--which is 10% less than the average level of spending actually incurred during 2007 and 2008--

[11] As noted by Mr. Persells, "Other Capital Projects" consist of (1) large non-recurring projects, (2) new projects having no historical, comparable spending levels, or (3) revenue-generating projects. In the present case, he continued, these include expenditures necessary to satisfy new, federally-imposed security requirements, build the highly-beneficial Sumpter Pipeline Extension, undertake much-needed pipeline integrity work, implement an aggressive revenue protection program, purchase the facilities necessary to serve a new industrial customer in the Gaylord area, and continue its meter relocation program. See, 4 Tr 509-521.

represents a “balanced request that recognizes the current difficult economic conditions, while providing adequate insurance for the safety and reliability of Mich Con’s system.” Mich Con’s initial brief, p. 47 (citing 4 Tr 508-509).

The Attorney General disagrees with the utility, contends that Mich Con’s projected capital expenditures “are out of touch with the economic condition of its service territory,” and asserts that those costs should thus be reduced by approximately $45 million annually. Attorney General’s initial brief, p. 17. In support of this position, the Attorney General cites testimony from his witness, Sebastian Coppola, to the effect that reducing routine capital expenditures for 2010 by $15 million “should be doable,” particularly when the result would still be a spending level in excess of that incurred during 2009. 6 Tr 1620. As for non-routine capital expenditures, the Attorney General advocates reducing proposed spending on Mich Con’s pipeline integrity and meter relocation programs by over $20.4 million and $8.8 million, respectively, all on the grounds that the Company failed to adequately support its requested level of spending. Id., pp. 17-18, citing 6 Tr 1620-1621.

The Staff takes issue with the Attorney General’s position and, instead, recommends that the Commission adopt Mich Con’s proposed capital expenditure levels as reasonable. In so doing, the Staff asserts that although its recommendations in this case “consider the economic conditions in the Company’s service territory and the state as a whole,” the preeminent responsibility of any utility like Mich Con is to provide “safe and reliable service to its natural gas customers.” Staff’s reply brief, p. 8. Moreover, the Staff’s review of the Company’s facilities (and, in particular, the state of its metallic distribution and operating systems) has raised concerns regarding Mich

Con's continued ability to meet that responsibility. See, Staff's initial brief, pp. 56-72. It therefore contends that, regardless of the present economy, the utility's proposed 2010 capital expenditure levels should not be scaled back.

The ALJ concurs with Mich Con and the Staff, and concludes that the utility's overall proposed capital expenditure level of $157 million should be approved by the Commission for use in the 2010 projected test year. In reaching this conclusion, the ALJ notes that--as correctly pointed out by the Company--the figure Mich Con currently advocates for routine construction (namely, $95.9 million) is less than the utility's actual spending on those activities during either 2007 or 2008.[12] Moreover, while Mich Con temporarily reduced spending on this area last year in recognition of 2009's "major economic recession," the Attorney General's own witness concedes that:

> This 'gloom and doom' scenario has since changed to a more promising economic outlook. Auto companies and suppliers have reorganized or are in the process of doing so. Economic production has stabilized and in many areas is rebounding and growing again.

6 Tr 1599. Finally, and as will be discussed at length later in this PFD, recent data indicates that the Company's system is in need of significant physical improvement if it is to provide the type of safe and reliable gas service that the Staff, the Commission, and its customers have all come to expect. Along those lines, it should be noted that (as discussed by Mr. Persells) adopting the Attorney General's reduced level of funding for non-routine capital expenditures could well preclude Mich Con from conducting the federally-mandated assessments of all transmission lines located in "High Consequence Areas" by the December 17, 2012 deadline recently imposed by the U.S. Department of Transportation, while also negatively effecting the utility's proposed revenue protection

[12] Specifically, Mr. Persells pointed out that the utility spent $110.2 million and $103.7 million, respectively, on routine construction during those two years.

program, Wolverine service line acquisition, and customer meter relocation program. See, 4 Tr 517-534.

3. AMI Program Costs

The final area of dispute with regard to the appropriate level of net utility plant to be adopted in this case concerns $1.5 million of capital expenditures that were included in Mich Con's 2008 historical test year due to its implementation of an AMI pilot program. Although the Company did not include any capital expenditures related to the AMI program in its 2010 test year figures, a discovery response received by the Attorney General indicated that "it anticipates moving ahead with an AMI installation program . . . expected to cost $110-120 million over a 6-8 year period." Exhibit AG-19, p. 3.

The Attorney General argues that, when he inquired regarding whether Mich Con had conducted a cost/benefit analysis regarding this program, Mr. Persells indicated that (1) the Company had done so, (2) the analysis was not included as part of the utility's filing in this case, and (3) he could not recall the analysis' results. Attorney General's initial brief, p. 20, citing 4 Tr 548-549. The Attorney General goes on to assert that "it is amazing that the company can expend millions on a pilot program and request hundreds of millions more but not produce any cost/benefit analysis" in support of the program, particularly during such trying economic times. Id. As a result, he contends that the Commission should order Mich Con to both "file a comprehensive cost/benefit analysis about the AMI program in its next rate case and defer incurring any further capital expenditures" with regard to it until the Commission specifically approves the program's continuation. Id., at 21.

Mich Con responds by noting that the Commission rejected similar arguments when granting The Detroit Edison Company (Detroit Edison) AMI-related cost recovery in the context of Case No. U-15244. In that case, Mich Con notes, the Commission explained that:

> UWL 223 argues that none of the AMI costs should be recoverable until the Commission can ensure that the benefits of the AMI exceed any associated costs and that important customer protections must be in place before AMI program implementation.
>
> AARP joins in the union's arguments and states that the costs of AMI are very high. . . . .
>
> The Commission finds that AARP and UWL 223's arguments on this issue are without merit. Detroit Edison may recover the expenses associated with the AMI project, as well as the infrastructure costs included in net plant from that pilot. The Commission favorably views the company's investment in a more technologically advanced infrastructure and is pleased to learn of the progress made in this area. Cost recovery beyond the AMI pilot project will be decided in future rate cases.

December 23, 2008 order in Case No. U-15244, pp. 61-63. According to the Company, the Commission should not be "required to fully relitigate its earlier decision," and the Attorney General's claims should be summarily rejected. Mich Con's reply brief, p. 39.

The Staff agrees, in significant part, with the utility's position, and supports the continuation of the AMI project. Furthermore, it asserts that the Attorney General's argument is "premature" in light of the fact that Mich Con "did not include any capital expenditure related to the AMI pilot program" as part of the recovery requested in this proceeding. Staff's reply brief, p. 9. Nevertheless, it recommends that the Company "submit a detailed cost benefit analysis at the conclusion of the pilot before it considers fully deploying AMI." Id.

The ALJ concurs with the Staff (and, albeit to a lesser degree, the utility) concerning this dispute. As expressed by the Commission's above-quoted order in Case No. U-15244, significant benefits will likely arise from implementing an AMI program in Mich Con's service territory. This, in turn, would appear to justify recovering whatever reasonable costs arise (or, in the present case, have already arisen and been assigned to ratepayers) from undertaking an AMI pilot program. Moreover, because no AMI-related costs have been included in Mich Con's current request for rate relief, the Staff is correct in arguing that the Attorney General's request for an order barring the incurrence of any such expenses is premature and must be rejected. Nevertheless, the vast expense expected to arise from the system-wide implementation of AMI, when coupled with the fact that Mich Con already appears to have analyzed the costs and benefits of its pilot program, justifies requiring the Company to provide a detailed cost/benefit analysis prior to the full deployment of AMI, as suggested by both the Attorney General and the Staff.

B. Working Capital

Working capital is the amount of funds required to bridge the gap between the time of payment of a utility's expenses and the receipt of revenues from its customers. In the present case, the Staff and Mich Con proposed slightly different figures for the Company's working capital allowance. Again, while Mich Con now agrees to use the Staff's figure (namely, $685,170,000) as a starting point, it goes on to propose two changes to the Staff's recommendation.

1. MGP Costs and Related Account Balances

Mich Con's first proposed change to the Staff's working capital figure concerns a component of the utility's rate base that can be traced to the earliest days of the gas industry. Before the advent of interstate pipelines, local gas distribution companies would utilize natural gas only if it was produced at nearby wells. Manufactured gas, a mixture of carbon monoxide and hydrogen produced from coal, coke, or oil, thus became the primary gaseous fuel. At various points in time, the Company or its corporate predecessors held an ownership interest in 18 sites that each formerly housed a MGP. Unfortunately, MGP sites present significant environmental concerns and are therefore the subject of various statutory environmental cleanup requirements.

Having first become aware of this problem (as well as its attendant expense) in 1984, Mich Con immediately established a reserve in the amount of $11.7 million to cover future costs for MGP-related assessment and remediation activities. However, the utility neglected to request Commission approval to undertake deferral and amortization accounting prior to establishing that reserve. Consequently, in the December 22, 1988 order in Cases Nos. U-8635, U-8812, and U-8854, Mich Con's request for retroactive deferral of those costs was denied. The Commission went on to note, however, that the utility could properly request deferral and amortization of similar costs if it did so in advance. The Commission further concluded that, after a prudence review, any unamortized balance should be included in rate base.

Following issuance of that order, Mich Con became increasingly aware that the total cost of environmental assessment and remediation at its MGP sites would vastly exceed the $11.7 million initially set aside. The Company thus requested and received, in the context of its next general rate case proceeding, “advance approval of a deferral mechanism for recovery of the [MGP-related] costs in excess of the $11.7 million previously charged to this reserve.” October 28, 1993 order in consolidated Cases Nos. U-10149 and U-10150, p. 141. The structure approved by the Commission to account for MGP-related expenses, which was reaffirmed by the Commission in Mich Con’s most recent rate case [consolidated Cases Nos. U-13898 and U-13899] and remains in effect today, mandates that: (1) all costs shall be deferred in vintage year accounts based on the particular year in which they were incurred; (2) deferred costs shall be amortized over a 10-year period; (3) the 10-year amortization period for deferred costs shall commence the year following their deferral; (4) Mich Con shall pursue potentially liable third parties and insurers for funds to help offset MGP assessment and remediation expenses; (5) insurance proceeds shall be deferred in the year that they are received; (6) those deferred proceeds shall also be amortized over a 10-year period; and (7) the amortization period for the insurance proceeds should begin on the year following their recovery. See, Id., pp. 140-148.

In the present case, the Staff recommended reducing the Company’s proposed working capital allowance by $8,189,000 to reflect adjustments it felt were necessary with regard to both amortized and unamortized MGP-related expenses. See, 6 Tr 1716-1717, and 1735-1738. The primary basis for the Staff’s proposed reduction, at least according to its initial analysis, was that Mich Con’s insurance settlement recoveries exceeded its actual MGP assessment and remediation costs, thus producing--among other things--an unamortized balance of $0. See, Id., at 1736.

Mich Con objects to the Staff's proposed reduction, claiming that its adoption would inappropriately eliminate all environmental working capital from the Company's rate base. Based on rebuttal testimony provided by Mr. Rynearson, the utility contends that the Staff's overall working capital figure should be increased by $4,532,000, as reflected on Exhibit A-39 (column e). According to Mr. Rynearson, that figure is arrived at by (1) subtracting unamortized insurance recoveries in the amount of $2,444,000 from the Company's $10,860,000 in unamortized MGP-related costs incurred through August 2009, (2) reducing the result by both the $115,000 difference between the projected amortization of the MGP's regulatory asset and related insurance recoveries, and $5,269,000 in deferred environmental costs not related to MGPs, and (3) adding $1,500,000 to eliminate the working capital offset for the accrued injuries and damages liability for certain environmental costs that the Staff excluded from the MGP deferred asset. See, 4 Tr 424-428.

As noted in its initial brief, the Staff acknowledges that Mr. Rynearson's analysis "may have merit." Staff's initial brief, p. 8. Nevertheless, it goes on to assert that "it is still equitable to the ratepayers to not allow the Company to recover the costs incurred until the amount exceeds the insurance settlement recoveries." Id.

The ALJ disagrees with the Staff and finds that its position on this issue likely springs from an erroneous conclusion. As specifically noted by the Company:

> It appears that Staff's opposition to Mich Con's proposed [working capital] adjustment is based on a comparison of the net MGP Regulatory Asset as of August 31, 2009 of $10.860 million (which is the total incurred MGP costs of $20.160 million less $9.300 million of amortization) with the total MGP related insurance recoveries of $11.744 [million]. This comparison of the MGP Regulatory Asset balance, net of the cumulative amortization, to the Insurance Recoveries balance, without regard for any amortization, apparently led Staff to conclude that Mich Con has realized

> more insurance proceeds than it has actual incurred costs. Staff's conclusion is incorrect.

Mich Con's reply brief, p. 6 (citations omitted). A more accurate measure of the Company's net investment in MGP assessment and remediation would be to compare the *unamortized* MGP Regulatory Asset balance to the *unamortized* MGP Insurance Recoveries balance, which clearly shows that Mich Con's insurance proceeds do not exceed its MGP-related expenses. See, 4 Tr 425-426.

Done correctly, this comparison gives rise to a net working capital requirement of $8,416,000. Moreover, when the other adjustments described by Mr. Rynearson (and set forth above) are made, the overall adjustment that should be made to the Staff's working capital figure is an increase of $4,532,000. The ALJ therefore recommends that the Commission approve that change.

2. Accounts Payable and Income Tax Payable Correction

Mich Con's second proposed increase in the Staff's working capital figure has not generated any dispute on behalf of the other parties, including the Staff itself. Specifically, the Company notes that revising its testimony and exhibits to remove the utility's initial control premium request necessitated slight changes to the level of Accounts Payable and Income Taxes Payable. Taken together, those changes served to increase the necessary level of working capital by $2,085,000 for the 2010 test year. See, Mich Con's initial brief, p. 5, at fn. 9.

According to the Staff, it failed to pick up the Company's increase in working capital when building its direct case, and the change is thus not reflected in the testimony and exhibits offered by the Staff's witnesses. Nevertheless, it "does not object to increasing Staff's Working Capital recommendation by $2,085,000 to reflect the Company's revision." Staff's initial brief, pp. 6-7.

Based on the concurrence of the parties, the ALJ finds that this proposed change should be made and, therefore, recommends increasing the Staff's working capital figure by $2,085,000.

C. Conclusion

In light of the discussion and recommendations set forth above, the ALJ concludes that Mich Con's projected 2010 rate base should be set at $2,361,145,000. This level, which is based on the Staff's proposed net utility plant and working capital allowance figures, adjusted in the manner described above, is computed as follows:

Net Utility Plant (As Filed)	$1,669,358,000
Working Capital Allowance (As Filed)	685,170,000
Additional MGP-Related Costs	4,532,000
Accts. Payable/Inc. Tax Payable Adjustment	2,085,000
Total Rate Base	$2,361,145,000

IV.

CAPITAL STUCTURE AND RATE OF RETURN

In order to calculate Mich Con's revenue requirement, it is necessary to select a rate of return to be applied to the utility's rate base. This involves (1) determining the appropriate capital structure, that is, the relative percentages of debt, equity, and deferred income taxes used to fund the utility's operations, and (2) determining the proper cost rate for each component of the capital structure.

Despite widely differing views regarding what overall rate of return should be established in this case,[13] the parties have been able to reach agreement concerning several components of Mich Con's capital structure and the respective costs of various sources of capital. For example, the parties have now apparently agreed to include within the projected 2010 capital structure $123,424,000 in short-term debt,[14] $15,756,000 in customer deposits, $61,510,000 in Other Interest Bearing Credits (OIB Credits), $353,748,000 in deferred federal income tax (FIT), $20,000 in deferred investment tax credits (ITC), and a total of $8,835,000 in job development income tax credits (JDITC). They further appear to agree that the cost of short-term debt should be 6.24%, the cost of customer deposits should be 7.00%, the cost of OIB credits should be 6.24%, the cost of JDITC should be equal to the cost of permanent capital, and both deferred ITC and deferred FIT should be cost-free.

Based on the agreement of the parties, as well as supporting testimony provided by witnesses for Mich Con, the Staff, and the Attorney General, the ALJ finds that these figures are reasonable for use in this proceeding. It is therefore recommended that the Commission adopt these undisputed cost rates and capital structure levels.

Despite the above-mentioned areas of agreement, disputes do exist with regard to a handful of related matters. These consist of disagreements regarding both the amount and cost of long-term of debt to be included in Mich Con's permanent capital

---

[13] While Mich Con claims that its weighted, after-tax overall rate of return should be 7.30% and the Staff suggests using 7.11%, the Attorney General and ABATE assert that 6.67% should be adopted instead. See, Mich Con's reply brief, p. 21; Staff's reply brief, p. 21; and Exhibit AG-13 (Revised).

[14] Although attachments to Mich Con's post-hearing briefs entitled "Overall Rate of Return Summary" continue to list short-term debt at the level initially proposed by one of its witness (namely, $125,509,000), the briefs themselves specifically state that "Mich Con and the Staff agree on a short-term debt balance of $123.4 million." Mich Con's initial brief, p. 24, and reply brief, p. 11. In light of those explicit statements of agreement, the ALJ has no reasonable alternative but to assume that the utility simply neglected to revise that portion of its attachments.

structure, the most reasonable estimate of how much common equity to include, and the rate of return (i.e., cost of common equity) that should be authorized in this case. Each of these three issues is addressed below.

A. Amount and Cost of Long-Term Debt

Based on testimony provided by Kirk Megginson, a financial specialist in the Financial Analysis and Customer Choice Section of its Regulated Energy Division, the Staff recommends adopting a long-term debt balance of $934,511,000 for inclusion in Mich Con's 2010 test year capital structure, along with a cost rate of 6.22%. 6 Tr 1679-1680. These figures differ somewhat from those both proposed by the Company (namely, a $933,529,000 long-term debt balance and a cost rate of 6.24%) and subsequently adopted for use by the Attorney General's witness, Mr. Coppola. See, Exhibits A-11, Schedule D1 (Revised) and AG-13 (Revised).

According to Mich Con, the first of these differences arose from the Staff's failure to reduce the Company's total outstanding debt by "the unamortized discount on long-term debt amount from MPSC account 226," thus incorrectly inflating the long-term debt balance by $982,000. Mich Con's reply brief, p. 11 (citing 5 Tr 1345). The second, it contends, resulted from the Staff's unjustified "removal of interest rate hedges" from the computation of the cost rate for Mich Con's long-term debt. Id., p. 10. In that regard, the utility offered testimony to the effect that--much like fixing the price for forward gas contracts in the context of GCR proceedings--hedges protect ratepayers by locking in the interest rate for an upcoming debt issuance and thus removing the risk of a spike in that rate. Mich Con's reply brief, p. 11 (citing 5 Tr 1130-1131).

The Staff disagrees with the Company on both points. With regard to the first, it notes that Mr. Megginson's calculations began with the long-term debt balance figures provided by Mich Con in Exhibit A-11, Schedule D2, and then reduced the overall balance by the unamortized debt expense reported by the Company. See, Staff's initial brief, p. 15. Because the utility "never specified nor indicated the referenced $982,000 unamortized discount amount [from account 226] in its pre-filed testimony or long-term debt exhibit," the Staff asserts, that figure was not factored into the Staff's calculation and should not be included at this point. Id. As for the second area of difference, the Staff cites Mr. Megginson's testimony that "the Commission has not recognized interest rate hedges in previous rate orders related to locking in cost rates on long-term debt issuances," and that "hedging activities related to long-term debt are speculative and can lead to unnecessary and avoidable costs." 6 Tr 1680. For these reasons, the Staff continues to advocate using its proposed long-term debt balance of $934,511,000 and assigning that portion of Mich Con's permanent capital structure a cost rate of 6.22%.

With regard to first matter, the ALJ agrees with Mich Con that its proposed level of long-term debt should be adopted in this case. In so doing, the ALJ finds that the Company's figure is more reflective of reality and, despite the Staff's assertions to the contrary, was adequately supported on the record as a whole. Mich Con and the Staff agree that the utility's outstanding long-term debt balance at the close of the 2010 test year is $940,000,000 and that unamortized debt expense in the amount of $5,489,000 should be subtracted from that figure, leaving $934,511,000. See, Exhibit A-11, Schedule D2, Col. 12; Exhibit A-9, Schedule B5.1 (Revised), Col. 3, line 28; and Exhibit S-4, Schedule D-2 (Revised), lines 12-15. Moreover, uncontroverted rebuttal testimony offered by Mich Con's witness on this topic, Margaret A. Suchta, indicates that (1) the Company's unamortized discount on long-term debt totaled $982,000 on a 13-month average basis, (2) this amount should also be subtracted from the Company's long-term debt balance, and (3) the resulting long-term debt figure of $933,529,000 should be adopted for use in Mich Con's 2010 test year capital structure.[15] 5 Tr 1345.

However, with respect to the second matter--namely the issue of what cost rate to apply to long-term debt--the ALJ is not persuaded that the cost of interest rate hedges should be included in the computation of Mich Con's cost of capital. As correctly noted by the Staff's witness, Mr. Megginson, the Commission does not appear to have ever approved the recovery of such expenses in the context of a general rate case. Moreover, and as pointed out by the Staff:

> Interest rate hedges are essentially bets that interest rates could rise above a certain rate the Company locked in for a certain period of time. If the Company hedges correctly . . . it makes money, [and] if the Company hedges incorrectly . . . it requests that the costs of the hedge be passed off to ratepayers.

Staff's reply brief, p. 12. Finally, with regard to Mich Con's assertion that interest rate hedges are similar to devices commonly used in the context of GCR proceedings, the ALJ does not consider this to be an apt comparison in that, unlike here, (1) gas price hedging pertains to an actual, widely-traded commodity for which carefully-monitored

[15] According to Ms. Suchta, this information was included as part of the Company's initial filing, in as much as:

> Mich Con's long-term debt balance on Exhibit A-9, Schedule B5.1 (Revised), line 44, shows a 13-month average long-term debt balance of $939,018,000 which is the outstanding long-term debt balance of $940,000,000 less the unamortized discount balance of $982,000.

5 Tr 1345. Nevertheless, because the Company's initial provision of this information in such an oblique manner appears to have led to the present disagreement, the ALJ would recommend providing data like this more directly in any future rate case filings.

protocols have been established, and (2) the GCR plan and reconciliation process would appear to provide a ready means for ensuring that benefits arising from hedging activities are shared with the utility's ratepayers.[16]

For these reasons, the ALJ recommends that the Commission adopt Mich Con's proposed level of long-term debt (specifically, $933,529,000), along with the Staff's suggested cost rate (namely, 6.22%), when computing the utility's cost of capital.

B. Amount of Common Equity

Both Mich Con and the Staff seem to agree on the need for the Company to maintain, in its permanent capital structure, an equal balance of equity and debt. For example, testimony and exhibits submitted by the Staff support setting the utility's common equity balance at $934,801,000, which represents just over 50% of that structure's total. See, 6 Tr 1683 and Exhibit S-4, D-1, line 3. In arriving at this figure, the Staff's witness indicated that he began with the utility's actual common equity balance through July 2009, imputed retained earnings for both the remainder of 2009 and all of 2010 (but chose not to reflect any equity infusions), and then computed the 13-month average of the resulting common equity level to come up with the Staff's figure. 6 Tr 1683-1684. As for the Company, it offered testimony supporting a test year common equity balance of $948,236,000, which would represent 50.39% of its projected permanent capital. See, Exhibit A-11, Schedule D1 (revised). Mich Con went on to provide testimony and exhibits during the rebuttal phase of the proceeding addressing the difference between the Staff's proposal and its own.

[16] To the ALJ's way of thinking, a more accurate--albeit still somewhat imperfect--comparison could be made between interest rate hedging costs and stock floatation costs. Unfortunately for the utility (and as will be addressed later in this PFD), the Commission has yet to approve the recovery of such costs, at least on behalf of DTE's electric and gas subsidiaries.

According to Mich Con, the Staff's recommendation is inaccurate due to the fact that it was based on financial statements prepared using Generally Accepted Accounting Principles (GAAP), as opposed to Regulatory Accounting Principles. Because those GAAP-based statements report certain items--such as the Costs to Achieve (CTA) arising from Mich Con's Performance Excellence Process (PEP)--differently than the manner provided for by Commission-issued accounting orders, the Staff's reliance on those statements "results in an understatement of the Company's common equity as reported for regulatory purposes." Mich Con's initial brief, p. 20. The Company further asserts that although using GAAP-based reports for the present purpose also requires that "adjustments be made for FAS 158 and deferred lost gas," the Staff failed to make any such adjustments. Id. (citing 5 Tr 1346). As a result, Mich Con contends that its common equity balance figure is both more accurate and more reliable than that proposed by the Staff.

The Staff responds by asserting that the Company "failed to provide a detailed estimate of its common equity balance" as part of its initial rate case filing, thus necessitating its use of the utility's GAAP-based monthly financial reports to develop its own proposal. Staff's initial brief, p. 16. According to the Staff, Mich Con's primary witness concerning this matter, Ms. Suchta, later stated that (1) the submission of such information was not mandatory pursuant to the Commission's newly-adopted rate case filing requirements, and (2) one of the Company's other witnesses, Mr. Rynearson, had adequately outlined the assumptions behind Mich Con's common equity balance figure as part of his direct testimony. However, the Staff continues, not only did the cited testimony fail to "detail the Company's common equity balance," it also failed to "describe the Company's prescribed adjustments for FAS 158 and deferred lost gas." Id. Moreover, the Staff asserts that although one exhibit submitted with the Mich Con's initial filing "outlined the changes to the Company's estimated 2010 equity balance based on the FAS 158 adjustments, Accumulated OCI adjustments, deferred lost gas adjustments, and other adjustments," no explanation or background was provided for any of those adjustments. Id., citing Exhibit A-29. Claiming that the Mich Con's actions made it impossible to verify the accuracy of the Company's proposed capital structure, the Staff contends that its balance figures should be used instead.

Although conceding that the Company's initial filing could have been (and, in the future, should be) more detailed and complete, the ALJ finds Mich Con's proposed level of test year common equity to be better supported than the Staff's GAAP-based figure, and thus worthy of adoption by the Commission. Notwithstanding the Staff's claim that Mich Con did not provide sufficient detail and explanation for its proposed common equity balance, the assumptions underlying the Company's proposal were at least briefly outlined in Mr. Rynearson's direct testimony, and further addressed by the underlying financial models. See, 4 Tr 413. In addition, Ms. Suchta's rebuttal testimony provided a more detailed reconciliation of the change in the Company's common equity balance between the historical and projected test years, as expressed on Exhibit A-29. See, i.e., 5 Tr 1347-1348. Thus, when viewed as a whole, Mich Con's proffered testimony and exhibits provide sufficient information and analysis to support its projected common equity balance. Moreover, as correctly noted on page 21 of its initial brief, the overall reasonableness of the Company's projected permanent capitalization is corroborated by the fact that Mich Con's actual equity-to-permanent capital ratio averaged 50% for the five-year period ended December 31, 2008, and should be carried forward by both its announced plan to remain at or above a 50% long-term debt to equity ratio[17] as of December 31, 2010 through equity infusions by DTE or growing retained earnings. See, i.e., 5 Tr 1112-1113. Accordingly, the ALJ recommends that the Commission adopt Mich Con's projected common equity balance of $948,236,000.

In light of the factors noted above, the ALJ recommends that the Commission include, as the second component of Mich Con's 2010 test year permanent capital structure, common equity in the total amount of $948,236,000, as proposed by the Company.

C. Cost of Common Equity/Authorized Rate of Return

As noted by the parties to this case, the criteria for establishing a fair rate of return for public utilities like Mich Con is generally drawn from the language set forth in two decisions issued by the United States Supreme Court. Specifically, in Bluefield Water Works and Improvement Co. v. Public Service Commission, 262 US 679, 692 (1923), the Court noted that:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.

Subsequently, but in the same vein, the Court stated that:

[17] The Company goes on to contend that, should the Commission "not adopt Mich Con's proposal in Case No. U-15699 to maintain [its] currently-authorized depreciation rates," the utility's "equity ratio would have to increase to a 52% to 53% range" to avoid a credit rating downgrade. See, Mich Con's reply brief, p. 8 (fn. 12). The ALJ finds that, in addition to being wholly speculative, neither this assertion nor its proposed resolution have been adequately reviewed and addressed by the parties. As a result, this issue should be deferred for resolution in a future general rate case.

> From the investor or company point of view, it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard, the return to the equity owner should be commensurate with the returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Federal Power Commission v. Hope Natural Gas Co., 320 US 591, 603 (1944). The Court has therefore made it clear that, in establishing a fair rate of return on common equity, the Commission must give consideration to ratepayers and shareholders alike. Specifically, the rate of return should not be so high as to place an undue burden on the utility's ratepayers, yet should be high enough to ensure investor confidence in the company's financial well-being. The Court has, however, refrained from endorsing any single formula or combination of formulas to use in arriving at the appropriate rate of return.

Moreover, when a utility stands alone and its common stock is publicly traded, direct approaches can be applied to accurately estimate a fair rate of return on the utility's common equity. However, the process becomes more complicated when the utility is a subsidiary of a holding company, as is the case with Mich Con. Because the stock of a subsidiary is not publicly traded, expert witnesses are forced to resort to indirect or proxy approaches to estimate the utility's cost of common equity. In the present proceeding, three witnesses took on this task, one each on behalf of Mich Con, the Staff, and the Attorney General.

The utility's witness, Dr. Roger A. Morin, concluded that 11.25% would constitute a "conservative, just and reasonable" return on common equity for Mich Con, assuming that the Company's proposed capital structure is adopted (as was recommended above) and that its requested RDM is approved. See, 5 Tr 1025. His conclusion was based on numerous studies performed using a traditional Capital Asset Pricing Model (CAPM),[18] an empirical CAPM, a risk premium analysis, and various Discounted Cash Flow (DCF)[19] analyses.

Inclusive of a 0.3% upward adjustment for flotation costs (which he succinctly describes as being "very similar to the closing costs on a home mortgage"), Dr. Morin's analyses produced a range of results running from 9.0% to 12.4%. See, 5 Tr 1045-1073. Based on his opinion that the CAPM results should be "accorded less weight than the DCF results," he went on to conclude that the average of all those tests is approximately 11.0%. See, 5 Tr 1078. To that figure, Dr. Morin recommended adding 25 to 50 basis points to reflect the fact that his estimates are based on a group of companies that exhibit less business risk than Mich Con, among other factors. In so doing, he asserted that "Mich Con's risk environment exceeds the industry average" as a result of "the difficult economic climate in Michigan," and that the Company suffers from both "the lack of an [RDM] and weak financial metrics for its credit rating." 5 Tr 1024. Based on that testimony, Mich Con asserts that its authorized rate of return should be set at either 11.25% if the Commission adopts its proposed capital structure

[18] The CAPM describes the relationship between a security's investment risk and its market rate of return, and tries to identify the rate of return that investors expect a security to earn so that its market return is comparable with the market returns earned by other securities with similar risks.

[19] The DCF is based on the dividend discount model of financial theory. The dividend discount model maintains that the value of any security is the discounted present value of all future cash flows arising from that issuance, including all dividends received and the stock's future sales price.

and approves the utility's request to implement an RDM, or 11.5% if those two requests are denied.[20]

Mr. Megginson, who served as the Staff's witness on this issue, recommended a return on equity of 10.85%, which was based on a range of reasonableness of 10.5% to 11.0%. See, 6 Tr 1684. In reaching this conclusion, Mr. Megginson began by selecting a proxy group consisting of 12 publicly-traded utilities, each of which met the following criteria: (1) net plant in excess of $650 million; (2) no less than 40% of the utility's income must be derived from natural gas service; (3) a minimum investment grade rating of BBB- or Baa3 from Standard & Poors and Moody, respectively; (4) currently paying dividends to shareholders; and (5) not involved in a major merger, acquisition, or buyout. Having selected a proxy group whose "data should provide a reasonable approximation of Mich Con's required cost of equity," he then performed DCF, CAPM, and risk premium analyses, and also reviewed other state commissions' recent decisions regarding the rate of return authorized for their regulated utilities.

The DCF analysis conducted by Mr. Megginson produced an "adjusted" cost of 9.71%, his "average" CAPM analysis produced rates of 9.64% for the prior 82 years and 8.88% for the past 50 years, and his risk premium review resulted in a cost figure of 11.30% (without the inclusion of flotation costs). See, 6 Tr 1992, 1695, and 1697. Moreover, his review of other state commissions' recent decisions regarding a utility's authorized rate of return led him to conclude that the average rate approved was

[20] As mentioned earlier, the rate of return figures offered by Dr. Morin and advocated by the utility for adoption in this case include a 0.3% upward adjustment for flotation costs. According to that witness, it is unreasonable to ignore flotation costs because "common equity capital is not free" and because those costs "are not expensed at the time of issuance and, therefore, must be recovered via a rate of return adjustment." 5 Tr 1073.

10.40%. Id., at 1697. The Staff went on to note that, at least in its opinion, the flotation cost adder requested by Mich Con should not be approved because:

> As previously discussed, Mich Con does not publically issue stock, and thus, the Company will not [actually] incur flotation costs. Further, in Case No. U-13808, the Commission denied the inclusion of flotation costs . . . and has repeatedly upheld this decision."

Staff's initial brief, p. 19. As a result, the Staff supports a return on common equity equal to 10.85% in this case.

The only other party to offer a detailed analysis regarding what return on common equity should be authorized was the Attorney General, whose witness--Mr. Coppola--advocated adopting a rate of 9.60%. See, 6 Tr 1627. Mr. Coppola's recommended figure assumes that the Commission approves an RDM covering "load losses associated solely with energy conservation" (as opposed to reductions in sales arising from warmer-than-expected weather), and further assumes that "the Commission approves the [company-proposed] UETM, but not the [LGTM]." See, 6 Tr 1627-1628. Specifically, he stated that his DCF, CAPM, and risk premium approaches to computing Mich Con's cost of common equity resulted in an average cost of 10.36%, to which he added 0.04% to cover flotation costs, and then subtracted 0.80% to:

> reflect the benefit and risk reduction to the Company from the [UETM] true-up mechanism in place since 2005 and from the likely implementation of [an RDM]. Both of these mechanisms insulate the Company from increases in uncollectable gas expenses and margin losses from conservation load losses.

Attorney General's initial brief, p. 23 (citing 6 Tr 1630-1631).

With regard to his proposed reduction in the Company's cost of equity due to its proposed RDM and other tracking mechanisms, Mr. Coppola explained that:

> These mechanisms substantially reduce the Company's risk profile. Consistent with the Bluefield decision mentioned earlier, the return to be realized in setting rates should be reflective of all "corresponding risks and uncertainties" and by extension all risk mitigation programs.
>
> Since 2005, the Company has had in place [a UTEM that] allows the Company to recover 90% of any uncollectable gas costs that exceed a base amount set in the company's last rate case. If these costs fall below the base level, the Company will refund 90% of the shortfall. Based on information provided by the Company, I have calculated in Exhibit AG-6 the benefit to the Company of having this mechanism in place. With a significant increase in uncollectable expense in the last three years, I estimate that the Company has collected approximately $68.8 million more than it would have if it had not had the true-up mechanism in place and had to file annual rate cases. As a result, I estimate that the Company has enhanced its return on common equity by approximately 1.69 percentage points on average over the past three years.
>
> Similarly, allowing the Company to implement [an RDM] will further mitigate risk and protect Company profits. Exhibit AG-4 analyzes information obtained from a work paper prepared by Company witness Feingold related to the loss of non-gas revenue due to reductions in customers' average gas consumption from 2005 to 2008. The analysis estimates that over this four year period the Company lost $90.3 million of revenue (excluding the impact of weather). . . . Therefore, an RDM that protects the Company from this risk will be a significant benefit to the Company to shield it from lost profits.

6 Tr 1641-1642. Mr. Coppola went on to recommend that further reductions in Mich Con's authorized rate of return should be made if the Commission elects to approve either (1) the Company's proposed version of an RDM, which would shield Mich Con from all weather-related reductions in projected sales levels, and (2) the utility's proposed LGTM. Specifically, he asserted that adopting the Company's version of the RDM would justify "an additional downward adjustment of 0.30%," while approval of its proposed LGTM would necessitate a further 0.25% reduction in Mich Con's cost of common equity. 6 Tr 1644.

The last party to weigh in on this matter was ABATE, who generally agrees with the position offered by the Attorney General's witness. Specifically, ABATE asserts that the financial analyses conducted by Mr. Coppola fully support his proposed 9.60% rate of return, and that his other two potential downward adjustments should be adopted if the Commission approves Mich Con's version of the RDM and its requested LGTM. See, ABATE's initial brief, p. 12. According to ABATE's witness, James T. Selecky, this assertion is based on the fact that implementation of an RDM, UETM, and/or LGTM will significantly reduce the Company's business risk, and that "if the Commission is going to guarantee Mich Con a significant portion of its revenue stream, it should reflect the lowering of Mich Con's risk in the authorized return on equity it approves." Id. (citing 6 Tr 1568). Doing so, ABATE concludes, would be consistent with actions taken in other jurisdictions where utilities' returns on common equity have been reduced due to the adoption of RDMs.[21]

The only area in which ABATE appears to diverge from the analysis provided by the Attorney General's witness concerns the issue of flotation costs. Specifically, although Mr. Coppola's computations included a small flotation cost adder (namely, 0.04%), ABATE joins with the Staff in advocating against the inclusion of any such costs on the grounds that they are not costs actually incurred by the utility, but instead

[21] For example, Mr. Coppola testified that, in a recent case involving the Potomac Electric Company, "the Maryland Commission reduced the authorized rate of return on common equity by 0.50%, from 10.5% to 10.0%, to take into consideration the business risk mitigated by the revenue decoupling mechanism." 6 Tr 1644. In addition, Mr. Selecky cited similar actions taken by the Connecticut Department of Public Utility Control, the Missouri Public Service Commission, and the Indiana Utility Regulatory Commission. See, 6 Tr 1568-1569. Apparently sensing that ABATE and/or the Attorney General are seeking adoption of "a standard or uniform basis point reduction" in the rate of return authorized for any Michigan utility that implements an RDM, the Staff recommends that further study is necessary before implementing an across-the-board reduction of that type. See, Staff's reply brief, p. 15.

constitute operating expenses of the utility's holding company. ABATE therefore reiterates that the Commission has consistently said:

> The exclusion of flotation costs is appropriate. The Commission is persuaded that these costs are not incurred by the regulated utility. Consequently, it is not appropriate to include these costs in the calculation of [the utility's] return on equity.

ABATE's reply brief, p. 3 (citing the Commission's November 23, 2008 order in Case No. U-13808, p. 42).

Turning first to the issue of flotation costs, the ALJ agrees with ABATE and the Staff that such costs should not be factored into Mich Con's cost of common equity (and ultimately collected from the Company's ratepayers). As noted in Case No. U-13808 and elsewhere, Mich Con is not a publicly traded company and, thus, it never actually incurs flotation costs. Rather, they are incurred exclusively by DTE, who issues all new common equity and is allowed to deduct those costs when computing its taxes. The ALJ therefore recommends that the Commission exclude flotation costs when establishing Mich Con's cost of common equity, consistent with the Commission's previous rulings on this issue.

As for the broader issue, namely what cost level to assign to common equity in this case, the ALJ concludes that the Staff's range (from 10.5% to 11.0%) appears more reasonable than the ranges or precise figures offered by the utility or the Intervenors. Unlike the other cost of capital witnesses, the Staff's expert--Mr. Megginson--gave a reasonable amount of consideration and weight to all of the various methodologies available for use in estimating Mich Con's true cost of common equity. Furthermore, a step-by-step review of his various analyses indicates that, on the whole, the inputs and assumptions used in his financial models are realistic in light of current and expected market conditions. Finally, Mr. Megginson appears to have applied sound and unbiased reasoning both in conducting his various analyses and interpreting their results.

Having settled on a realistic range of rates, the final step is to select the most reasonable return on equity to be authorized in this proceeding. In doing so, the ALJ concludes that the lower point of the Staff's range--specifically, 10.5%--represents the most appropriate cost of common equity for Mich Con for the 2010 test year and beyond. This conclusion is based on the following four factors.

First, the Staff's review of recent decisions issued by other regulatory agencies revealed that the average approved return on equity was 10.4%. Thus, while the rate of return recommended in this PFD is admittedly at the low end of the Staff's range, it is 10 full basis points above the average granted by other state commissions. Second, the overall range of rates (9.0% to 12.4%) provided by Mich Con's own witness, Dr. Morin, results in a midpoint of 10.7%. Adjusting that figure to remove his 0.3% flotation cost adder (consistent with the above-mentioned finding) also produces a cost rate of 10.4%. Third, as noted earlier, Mich Con has been experiencing a very stable capital structure (with its equity-to-permanent capital ratio averaging 50% for the five-year period ended December 31, 2008) and has pledged to take all steps necessary to maintain such levels in the future. 5 Tr 1112-1113. This strategy, when coupled with the ALJ's recommendation to adopt the Company's proposed levels of long-term debt and common equity, should help reduce the financial risk faced by Mich Con's common equity shareholders, thus reducing the cost of equity. See, 5 Tr 1114-1115.

Fourth, and most importantly, in light of the significant reduction in risk that should result from the recommended approval of an RDM and continued use of the existing UETM (albeit, on a slightly revised basis), a cost rate of 10.5% is more than generous. In light of these factors, the ALJ recommends that the Commission adopt 10.5% as Mich Con's cost of common equity.

D. Conclusion

Based upon the recommendations set forth above, the ALJ finds Mich Con's overall rate of return to be 6.99%. This figure can be calculated as follows:

PERMANENT CAPITAL STRUCTURE

Description	Amount	Ratio	Cost Rate	Weighted Cost
Long-Term Debt	$933,529,000	49.61%	6.22%	3.09%
Common Equity	$948, 236,000	50.39%	10.50%	5.29%
Total Perm. Capital	$1,881,765,000	100.00%		8.38%

RATEMAKING CAPITAL STRUCTURE

Long-Term Debt	$933,529,000	38.18%	6.22%	2.37%
Common Equity	$948, 236,000	38.78%	10.50%	4.07%
Short-Term Debt	$123,424,000	5.05%	6.24%	0.32%
Customer Deposits	$15,756,000	0.64%	7.00%	0.04%
OIB Credits	$61,510,000	2.52%	6.24%	0.16%
Net Deferred FIT	$353,748,000	14.47%	0.00%	0.00%
Deferred ITC	$20,000	0.00%	0.00%	0.00%
JDITC				
Long-Term Debt	$4,383,000	0.18%	6.22%	0.01%
Common Equity	$4,452,000	0.18%	10.50%	0.02%
Total JDITC	$8,835,000	0.36%		0.03%
TOTAL	$2,445,048,000	100.00%		6.99%

V.

ADJUSTED NET OPERATING INCOME

In order to determine whether a revenue deficiency or excess exists, it is necessary to establish the utility's adjusted net operating income for the test year. This is accomplished by estimating the utility's likely test year operating revenues and comparing them to its expected operating expenses. In the present case, the first step in this process is to determine what level of throughput will likely be experienced by Mich Con during the 2010 test year.

A. Throughput

Throughput represents the total gas sales and transportation volumes delivered to end-use customers. It is established in a general rate case as a prerequisite to computing expected test year revenues. Throughput is also used, along with the estimated number of customers for each of the utility's respective rate classes, in resolving rate design issues.

In the present case, Mich Con projected that it would have 1,182,076 sales customers at the close of the 2010 test year, along with 657 end-use transportation (EUT) customers. See, Exhibit A-12, Schedules E-2, p. 2, and E-10. It also projected that it would experience sales volumes of 152.3 billion cubic feet (Bcf), excluding sales related to new customer attachments, as well as transportation volumes of 88.6 Bcf. See, Exhibits A-12, Schedule E-2, p. 1, and A-45. These figures represent a significant reduction from those adopted in Mich Con's last rate case, and provide the primary basis for the Company's claim that it has a revenue deficiency in excess of $192 million.

The utility's large proposed reduction in system-wide gas usage stems for two areas that are now in dispute, specifically weather normalization, on the one hand, and both the projected number and individual usage levels of its customers, on the other.

1. Weather Normalization

As explained by George H. Chapel, Mich Con's Manager of Market Forecasting, weather normalization "adjusts actual consumption from a past period to eliminate the impact of warmer than normal or colder than normal weather"--which essentially consists of daily temperatures from the historic period measured in heating degree days (HDDs). 5 Tr 832. Weather normalized historical gas consumption is used as the basis for forecasting future consumption. In the context of this case, that future consumption would be the amount of gas expected to be used during the projected 2010 test year.

According to Mr. Chapel, he compared actual HDDs recorded from 1951 to 2008 through the application of four different weather normalization models, with the result of that comparison depicted on Exhibit A-12, Schedule E6. Those four methods consisted of (1) the most recently published National Oceanic and Atmospheric Administration (NOAA) normal, which covered the period from 1971 through 2000, (2) the 30-year rolling average ended 2008, (3) the 10-year rolling average ended 2008, and (4) the "hinge fit" method recently developed by Dr. Robert Livezey, an independent climate expert.[22] Based on that comparison, Mr. Chapel concluded that the "hinge fit" technique best reflects the "strong linear trend of warming temperatures after the mid-1970s," and

[22] In addition to holding faculty positions at Penn State University and the University of Missouri-Columbia, serving as a hurricane modeler, performing research for the NOAA's Climate Prediction Center, and holding the position of Chief of the Experimental Climate Forecast Division at NASA's Goddard Space Flight Center, Dr. Livezey most recently served as head of all National Weather Service Climate Services. 4 Tr 126-128.

thus provides "the most accurate method of forecasting weather normal for 2010." Mich Con's reply brief, p. 23 (citing, 5 Tr 832-836).

Mich Con therefore used the "hinge fit" methodology, in accordance with the recommendations of Dr. Livezey, to produce the normalized customer consumption level proposed for adoption by the Company. In support of Mich Con's proposal, he testified that:

> While there may be controversy over the cause of climate change or the seriousness of its impacts, there is virtually no reasonable controversy remaining over the fact that measureable climate change has taken place since the 1970's, globally as well as over the United States, and that the temperature increase is greatest over Northern Hemisphere continents in the wintertime.

4 Tr 135. More to the point, Dr. Livezey noted that both U.S. and Michigan winter weather data "clearly fit the hinge shape that our research validated as a tool for tracking global climate change," thus making the "hinge fit" methodology much more accurate than 30-year weather normals in computing HDDs. 4 Tr 150.

The Attorney General opposes Mich Con's proposed use of the "hinge fit" methodology, and instead recommends that "the Commission should continue to use a 30-year weather normalization approach to forecast gas deliveries" for Mich Con's test year, "utilizing the most recent 30 years of [HDDs]." Attorney General's initial brief, p. 2 (citing Mr. Coppola's testimony on 6 Tr 1596). In support of this recommendation, the Attorney General's witness asserts that the "hinge fit" method essentially calculates "a short term weather averaging result closer to a 12-15 year period," thus making it much less stable than a rolling 30-year approach. See, 6 Tr 1595-1597. His witness further contends that the "hinge fit" methodology "is a very complex model that cannot be readily duplicated and verified," thus depriving the Commission, the Staff, Intervenors, and other utilities of the opportunity "to assure its accuracy and to apply it consistently to other utility rate cases." 6 Tr 1596. Most importantly, the Attorney General claims that continued reliance on the 30-year weather normalization methodology would reduce Mich Con's asserted revenue deficiency by $17,777,000. Attorney General's initial brief, p. 6 (citing 6 Tr 1597). For these and other reasons, he recommends that the Commission adopt the same normalization method it approved for use by Mich Con in Cases Nos. U-13898 and U-13899.

For its part, the RRC recommends "a middle ground to the positions advocated by Mich Con and the Attorney General." RRC's initial brief, p. 6. Specifically, the RRC:

> agrees with Mich Con that the Company's weather normalized gas deliveries forecast should reflect the effects of climate change, however, the hinge fit methodology and its use of an 11-year weather normalization should not be adopted because it is untested in the utility regulation arena and as the testimony of RRC witness [Frank J. Hollewa] shows, it is not as stable as a 15-year rolling average and is not appropriate for Mich Con's service territory.

Id. Arguing that the Attorney General's recommended use of a 30-year normalization improperly ignores "very strong evidence of a warming trend," and that the "hinge fit" method's use of "a linear regression [starting] with the 10 coldest years (1976-1985) "dramatically overstates the rate of winter warming," the RRC instead advocates using a 15-year rolling average like that described in Mr. Hollewa's testimony.[23] Id., p. 14.

[23] In further support of its proposal, the RRC expresses its belief that the Commission should select and apply "one consistent criterion for Normal weather in the ratemaking process for Michigan's four major gas companies." Id., p. 15. In support of this recommendation, it notes that both Consumers Energy Company (Consumers) and SEMCO Energy Gas Company use 15-year rolling averages for GCR planning purposes, while MGUC uses a 30-year rolling average. Instead of having each utility develop and propose its own case for weather normalization (as Mich Con did in this proceeding), the RRC recommends adopting the 15-year average for use in each of these utilities' future cases. While notice problems would certainly arise from any formal pronouncement by the Commission to that effect in the context of the present case, the Commission may want to consider whether it might be worth initiating a generic proceeding concerning weather normalization.

As for the Staff, it asserts that despite supporting Mich Con's proposed sales level figures (which were based on weather normalization via use of the "hinge fit" method), it is "not advocating the use of any particular weather normalization approach." Staff's reply brief, p. 27. Moreover, the Staff asserts that should the Commission approve use of the Company's proposed weather normalization methodology (or either of the alternatives advocated by the Attorney General or the RRC) such approval should be strictly limited to this proceeding. Furthermore, the Staff recommends that whichever HDD weather adjustment is used to compute Mich Con's projected test year sales levels "should also be utilized in the reconciliation of whatever [RDM], if any, the Commission approves." Id.

The ALJ finds that, based on the record as a whole, the Company's proposed "hinge fit" technique appears to provide the most accurate way to develop normalized weather for use in establishing Mich Con's projected 2010 test year sales levels. Despite regulatory agencies' long-standing reliance on rolling 30-year averages like that currently advocated by the Attorney General, official NOAA climate forecasters and climatologists have "decided not to use 30-year weather averages" and, instead, fully acknowledge "the need to augment, if not totally replace, 30-year normals." 4 Tr 139. Moreover, based on testimony provided by Messrs. Livezey and Hollewa to the effect that global climate change is leading to a distinct winter warming trend in Michigan, application of the Attorney General's 30-year normalization methodology will significantly overstate heating demand--and thus overall gas sales--in Mich Con's service territory. See, 4 Tr 134-144; 6 Tr 1514; and Exhibit A-18, Schedule K1. As a result, the Attorney General's proposed 30-year method should not be adopted.

Moreover, while the RRC's 15-year normalization proposal would appear to constitute an improvement over the 30-year methodology adopted for use in Mich Con's last general rate case, the ALJ is not persuaded that it would provide more accurate figures than the Company's "hinge fit" model. Notwithstanding the RRC's assertion that the "hinge fit" methodology would yield less stable results on a year-to-year basis because it relies on only 11 years-worth of data, Mr. Livezey specifically testified that "the hinge fit is [actually] a 58-year regression to the hinge shape and has been shown to produce trend estimates with substantially smaller sampling error than even a 33-year record would imply." 4 Tr 184. Furthermore, he noted that "limited-area, short-record estimations" like that provided in support of the RRC's proposal can give rise to "huge sampling uncertainties," rendering them inferior to results produced by the "hinge fit" method. Finally, with regard to claims that Mr. Livezey's model is excessively complex and provides results that are difficult to verify or duplicate, the record reflects that the "hinge fit" is actually computed through the application of a "simple, unambiguous, and reproducible Excel algorithm," that can be easily applied to Company-specific data to arrive at the utility's HDDs. See, Mich Con's reply brief, p. 24 (citing 4 Tr 167).

For the above-mentioned reasons, the ALJ recommends adopting Mich Con's proposal to use the "hinge fit" methodology for purposes of weather normalization. Moreover, for reasons of consistency and based on the apparent absence of opposition by the other parties, it is also recommended that the Commission approve the Staff's request to use this HDD weather adjustment when reconciling any RDM ultimately adopted as a result of this proceeding.

2. Customer Count and Usage Levels

Mich Con's actual 2008 customer usage was 174.7 Bcf, which--using the "hinge fit" methodology--is weather-normalized to 166.4 Bcf. See, Exhibit A-45. Based on this starting point, the Company projects total 2010 rate schedule sales of only 152.3 Bcf. Exhibit A-12, Schedule E1. According to the utility, this drop of over 14 Bcf in annual customer usage is driven by the lingering economic recession, which is both reducing the population in Mich Con's service territory and increasing the incidence of non-payment (which, in turn, leads to a higher incidence of customer disconnects and gas theft). The Company also expects that per-customer sales volumes will decline due to both ongoing conservation and recently-established energy optimization programs. Overall, Mich Con's filing in this case projects a loss of 44,000 residential customers during 2009 and approximately 28,000 more during 2010. Exhibit A-12, Schedule E3. Mich Con likewise expects its number of commercial accounts to shrink, with its remaining customers also expected to use less gas. See, 4 Tr 220-221, and 5 Tr 843-846.

Although conceding that "much of this reduction is well justified given the economic conditions and population shift in the Company's service territory," the Attorney General's witness--Mr. Coppola--asserted that the utility was being "overly pessimistic" with regard to its estimated loss of customers and expected decline in per-customer consumption. 6 Tr 1599. Consistent with Mr. Coppola's assertion, the Attorney General concluded that using "a more reasonable analysis of gas sales" would reduce the utility's revenue deficiency by $27,387,000. Attorney General's initial brief, p. 8. In support of this conclusion, he argues that Mich Con's predicted decline in residential customers (namely, "a four-fold increase in customer losses" over previous levels) is not adequately supported in the record, and that the analysis prepared by Mr. Coppola and set forth on Exhibit AG-11 provides a more reasonable result. Id., p. 6. The Attorney General further argues that the Company's assumed 3.5% annual reduction in average gas consumption per residential customer is excessive, and that the level of decline computed by Mr. Coppola and expressed on Exhibit AG-10 (specifically 2.0%) should be adopted instead. See, Id., pp. 7-8.

The ALJ does not find these arguments persuasive, and instead concludes that the Company's projections regarding test year customer count and usage per customer are better supported on the record.

As pointed out by Mich Con's witness regarding this issue (namely, Mr. Chapel), a number of factors go into a utility's customer count forecast, including the expected number of (1) customer attachments, (2) locked out services, and (3) customers whose lines are cut and capped. See, 5 Tr 853-854. With regard to the first factor, uncontroverted testimony shows that, largely due to Michigan's continuing economic difficulties, "the Company's rate of attachments has fallen off in recent years and is projected to be even less in the future." Id., at 853. As for the other two, Mr. Chapel noted:

> An even bigger factor in the greater reductions in projected customer count is the Company's initiative to lock and cut & cap customers due to theft or arrearages. Due to locking/cutting customers at a greater rate than in the past, the Company projects a greater [annual] customer count reduction.

Id., at 854. Mr. Chapel further notes that the customer count estimate offered by the Attorney General's witness mistakenly assumes that 90% of the utility's locked-out or cut and capped customers will return to Mich Con's system, whereas the Company's actual reconnection rate for such customers has been only in the range of 40% to 65% since 2005. See, 6 Tr 1603; 5 Tr 854.

As for the Attorney General's argument regarding consumption per customer, it appears that this is based on the mistaken belief that Mich Con is projecting a 3.5% annual decline. While an error on Exhibit A-12, Schedules E1 and E8, could lead one to conclude that such a large decline was being projected, the Company subsequently corrected that error, thereby reducing its figure to 2.1%. 5 Tr 855. Moreover, testimony indicates that Mich Con's projected drop of 2.1% annually in gas usage per customer is reasonable in light of (1) updated usage factors which, by including data through the close of February 2009, reflect a reduction in customer consumption per HDD, (2) the fact that Mich Con appears to be "losing more high average use customers than low average use customers," and (3) an expanding level of customer conservation, apparently spurred in part by the recent implementation of Mich Con's EO program. See, 5 Tr 856-859. As a result, the ALJ recommends adopting the Company's estimates regarding both the number and gas usage rates of its customers during the 2010 test year.

3. Conclusion

For all of these reasons, the ALJ concludes that Mich Con's projected total 2010 rate schedule sales of 152.3 Bcf constitutes a reasonable figure, and recommends that this throughput level be adopted by the Commission for use in setting the Company's rates.

B. Operating Revenues

As stated in its testimony and illustrated on Exhibit S-3, Schedule C-3, the Staff proposes adopting $683,186,000 as the utility's adjusted total operating revenue for the 2010 test year. This figure includes all expected gas sales (less the cost of gas sold), $4,450,000 in revenue anticipated from Mich Con's contract with Exelon Energy Company (Exelon), the imputed recovery of all net discounts provided to customers under various "special contracts," all off-system (or, as Mich Con now refers to it, "Midstream") revenues arising from the utility's provision of either third-party storage or transportation service, and all "other operating revenue" expected to accrue during the test year. The only party taking issue with the Staff's proposed figure was Mich Con, who advocated making changes to three areas,[24] consisting of the Staff's suggested treatment of (1) potential discounts related to special contracts, (2) revenues related to late payment or non-sufficient fund (NSF) charges, and (3) third-party storage and transportation revenue.

1. Special Contract Discounts

Mich Con contends that the Staff's overall recommended level of 2010 test year distribution revenue must be reduced by $205,000 to reverse what the Company considers unwarranted disallowances regarding various long-term, fixed-price contracts that "include annual volume and revenue commitment true-up provisions," including its special contract with DIG. Mich Con's reply brief, p. 32. According to the utility, while

[24] Although the Company indicated (on page 33 of its reply brief) that it also took issue with the Staff's treatment of Gas-In-Kind as it pertained to "Other Operating Revenue," it failed to specifically address this matter as part of its proposed revisions to the Staff's overall operating revenue computation. Because this issue is (1) addressed as part of the detailed Cost of Service discussion later in this PFD and (2) resolved in favor of the Staff and ABATE, and in opposition to the Company, it does not lead to a recommended change to the Staff's proposed operating revenue figure.

the Staff suggests that a revenue shortfall will arise from these special contracts and that Mich Con should have supported its position with a more detailed cost of service study, these assertions miss the controlling point. Namely, the Company contends, the Staff's analysis failed to "assign the most applicable cost-based rate" to these contracts, thus leading to a "significant overstatement of the revenues" imputed to customers holding two of the six contracts in question. Id. Had the Staff used the proper rate when conducting its analysis, Mich Con continues, it would have seen that the utility's "special contracts and fixed rate contracts contribute a 46 percent uplift to the transportation rate class, thus concurrently (1) offsetting part of that class' cost of service, and (2) sending "a positive message that is needed to attract business and industrial development in Michigan." Id., p. 33.

The Staff disagrees with these assertions and opposes Mich Con's request to essentially recover what amount to distribution rate discounts from other full-paying customers. According to the Staff, Commission orders granting utilities' requests to provide discounts like these have consistently warned that each respective utility would bear a substantial and compelling burden to show the reasonableness of shifting any part of its discounts from the favored customers to other ratepayers. Specifically, the Staff's primary witness on this issue, Nicholas M. Revere, noted that the Commission's April 28, 2005 order in Cases Nos. U-13898 and U-13899 essentially required Mich Con to "present a cost study separating all of the costs attributable to the discounted customers and show [that] the contracts recover those costs, or show significant benefits to other ratepayers" before the cost of those discounts could be recovered in rates. 6 Tr 1854. In the present case, the Staff continues, the utility failed to satisfy that requirement.

The ALJ agrees with the Staff and recommends that the Commission reject Mich Con's request to effectively shift to other ratepayers $205,000 of costs caused by providing service pursuant to the special contracts in question.[25] Notwithstanding the Company's claim that it provided evidence showing that the revenues projected to be received from these contracts are essentially equivalent to those that would be received if the customers took service on other, previously-available rates (as opposed to those that will result from this proceeding) the ALJ finds that such a comparison is meaningless. As noted by Mr. Revere, the information provided by Mich Con fails to show that the overall revenue received under the contracts in question is actually sufficient to cover the current costs attributable to these specific discounted customers. See, 6 Tr 1855.

2. Late Payment and NSF Charge Revenues

The Staff's proposed operating revenue figure included the same level of late payment/NSF charge revenue as was recorded by the utility during calendar year 2008, or approximately $17,583,000. See, 6 Tr 1777; Exhibit S-3, Schedule C-3, line 11. Mich Con takes issue with that figure's use, claiming that the average of its late payment/NSF charge revenue for the last three historical years (namely, $15,795,000) should be used instead. In support of its claim, the Company asserts that, although these charges had been rising through 2008, they only totaled $12.6 million through November 2009 and were expected to be significantly lower in years beyond 2008 "due

[25] As noted on pages 40 and 41 of the Staff's initial brief, this would require imputing the revenues from all discounted customers (with the exception of DIG and Exelon) at the rates those customers would have paid in the absence of their special contracts.

to Mich Con's offering of additional payment plans to its customers." Mich Con's reply brief, p. 33 (citing 4 Tr 418).

The ALJ does not find the Company's assertion persuasive. Although it may be true that Mich Con will offer payment plans to more of its customers, the record reflects that the utility's late payment/NSF charge revenues have progressively climbed from $12,756,273 in 2006, to $17,045,125 during 2007, and then to $17,582,913 for 2008. See, 6 Tr 1777. Moreover, as noted by Steven Q. McLean, an analyst in the Staff's Regulated Energy Division, the level of revenue garnered in 2006 was significantly lower than that received in either of the two subsequent years, thus noticeably suppressing the three-year average. Id. The ALJ therefore finds that the Staff's figure is likely to be more representative of the actual level of late payment/NSF charge revenue that will arise during the 2010 test year. He thus recommends that the Commission reject Mich Con's alternative figure.

3. Third-Party Storage and Transportation Revenue

The Staff recommended including, as part of the Company's overall 2010 test year operating revenue, approximately $97.8 million in third-party (or off-system) storage and transportation revenue. See, Exhibit S-3, Schedule C-3, line 4. This consists of $46.4 million in storage-related revenue, and $51.4 million in transportation-related revenue. See, Exhibit S-5, Schedule F-2-5. Mich Con objects to the Staff's recommended figure, claiming that it overstates the third-party storage and transportation revenue it will likely receive during 2010 by a total of $15.2 million.

With regard to projected storage revenue, the Company claims that the Staff's decision to add $10.9 million to the levels the utility is projecting for 2010 is not--despite the Staff's assertions to the contrary--supported by Commission orders issued in Cases Nos. U-14800, U-15457, and U-15628. Moreover, Mich Con contends, it unreasonably assumes that the Company could sell its existing 17.5 Bcf of available storage capacity at an average price of $1.81 per Mcf, as opposed to the utility's current average rate of 97.5¢ per Mcf. Mich Con's reply brief, pp. 34-35. As for third-party transportation, the Company asserts that the Staff's figure (which essentially rejects Mich Con's claim that such revenue will drop by $4.3 million from historical levels) ignores the fact that the utility "no longer has the physical capacity" to offer gas exchange and loan services to the degree it could during 2008, and lacks the "incremental storage capacity . . . [and] off-system transportation capability to increase third-party revenue streams." Id., p. 35.

The ALJ is not persuaded by Mich Con's arguments and accepts the Staff's proposed third-party revenue numbers as superior. The Staff's recommended figures effectively adopt the storage and transportation revenue levels experienced in 2008, albeit with a negative $1.5 million "reclassification" noted by its witness, Bonnie Janssen. See, 6 Tr 1768; Exhibit S-5, Schedule F-2-5, lines 4 and 16. As also noted by Ms. Janssen, the Commission's August 21, 2007 order in Case No. U-14800, its December 4, 2007 order in Case No. U-15457, and its March 5, 2009 order in Case No. U-15628 should serve to allow Mich Con to sell more of its "excess storage gas," thus freeing up space for third-party customers to use in transporting and storing their own natural gas. 6 Tr 1767. Finally, and notwithstanding the Company's claim that they will likely decline between its historical and projected test years, data gleaned from annual reports filed with the Commission shows that Mich Con's overall off-system revenues rose steadily from 2005 through 2008. See, Exhibit S-5, Schedule F-2-5, line 28.

4. Operating Revenue Summary

Based on the above discussion, the ALJ recommends that the Commission adopt, for purposes of computing Mich Con's adjusted net operating income, the Staff-proposed total operating revenue figure of $683,186,000.

C. Operating Expenses

As with most general rate cases, a large percentage of the test year operating expense levels proposed in this proceeding were developed by simply taking Mich Con's historical expense figures from 2008 and adjusting them for inflation through the 2010 projected teat year. While initially at odds regarding the proper inflation rates to apply, it now appears that the Company has agreed to the application of the Staff's proposed rates of inflation, which has served to resolve several of these two parties' differences regarding the appropriate levels to establish for various Operation and Maintenance (O&M) expenses.[26]

Moreover, many of the remaining differences between the respective operating expense levels suggested by Mich Con and the Staff arise from the utility's request to include the SBPL in rate base, in contrast to the Staff's recommendation to defer taking any such action at least until the Company's next rate case. In light of the ALJ's earlier recommendation to refrain from including the SBPL in rates, all SBPL-related areas of disagreement have now disappeared, leaving a relatively small number of actively disputed issues regarding operating expenses.

[26] See, i.e., Mich Con's initial brief at page 53, where it specifically agreed to adopt the Staff's inflation rate of 1.55% for 2010, and Mich Con's reply brief at page 44, where the Company supported using the Staff's $304.4 million O&M expense figure, albeit with two non-interest-based adjustments.

Because the Staff's analysis of operating expenses was detailed and complete, and because Mich Con has now adopted many of the expense levels contained therein, it appears that the most expeditious way to proceed is to use the Staff's overall operating cost figure ($605,508,000)[27] as a starting point, and address only those areas where Mich Con or the other parties currently differ with the Staff's underlying figures.[28] Moreover, due to their potential effect on the utility's overall operating expenses, several other cost-related issues (including various set-aside funds, cost trackers, and true-up mechanisms) will also be discussed in this section, at least to the extent that portions of them are still in dispute.[29]

1. General Level of O&M Expense

The Staff recommends that the Commission adopt an overall level of O&M expenses for the 2010 test year of $304,422,000. In developing this figure, the Staff took Mich Con's projected O&M costs, reduced them to reflect both the application of its lower overall inflation factor and its proposed disallowance concerning employee incentive compensation program (EICP) costs, and then added back costs relating to the operation of an LIEFF program.

[27] This overall figure is drawn from Exhibit S-3, Schedule C-1, line 14, and reflected both on page 24 of the Staff's initial brief and page 20 of its reply brief.

[28] In the course of this proceeding, both Mich Con and the Staff noted that new depreciation rates would likely be established for the Company prior to the Commission's issuance of its final order in the present case. They further agreed that the effect of those new rates (on depreciation expense, in particular) should be reflected in the base rates ultimately approved in this case, and none of the other parties appear to object. On March 18, 2010, the Commission issued an order in Case No. U-15699 establishing those new depreciation rates. Thus, although the ALJ finds that the effect of those new rates should be factored into the Commission's final order in the present case, the timing of the order in Case No. U-15699 made it impossible to reflect their effects in this PFD.

[29] Nevertheless, issues that were handled earlier in this PFD and which do not result in any apparent change to the Staff's overall operating cost figure (including AMI program costs, the annual cost of capital expenditures, and MGP costs) will not be revisited.

Both the Attorney General and ABATE assert that, rather than using either the Staff's adjusted cost figure or the Company's original O&M expense request, the Commission should simply adopt--for use in the 2010 test year--Mich Con's historical 2008 O&M expense figure of $302,400,000. According to these two Intervenors, the poor economic conditions that continue to exist in the utility's service territory do not justify any increased spending on O&M. Rather, they contend that, based on the economic struggles faced by its ratepayers, the Company should freeze or cut pay and benefits for all of its employees, and take other steps to reduce its workforce. <u>See</u>, Attorney General's initial brief, p. 16, and ABATE's initial brief, p. 11. Both Mich Con and the Staff oppose those Intervenors' joint proposal.

The ALJ agrees with the Company and the Staff, and recommends rejecting the request of both ABATE and the Attorney General to limit all spending on O&M expenses to the level experienced in 2008. As Mich Con correctly notes, the "cavalier suggestion" that it could simply freeze or cut pay and benefits, or arbitrarily reduce its workforce, is both "unrealistic for purposes of operations" and "ignores the existence of the Company's labor contracts." Mich Con's reply brief, p. 46 (citing 4 Tr 1151). For those very reasons, the Commission recently rejected a nearly identical request to reduce Detroit Edison's O&M expense levels. <u>See</u>, the Commission's January 11, 2010 order in consolidated Cases Nos. U-15768 and U-15751 at p. 38. Moreover, a review of the Staff's various O&M expense recommendations indicates that, despite considering the economic situation on both Mich Con's service territory and the state as a whole, it still recognized the need to allow the Company adequate funding to "provide safe and reliable service to its natural gas customers." Staff's reply brief, p. 22.

2. EICP Costs

As alluded to above, the Staff's overall operating cost figure included the full disallowance of Mich Con's projected 2010 EICP expenses. According to the Staff, this disallowance (which leaves intact all other components of the Company's various compensation and benefits packages) removes the cost of "executive bonuses, executive perks, and employee incentive payments totaling an amount of $9,970,000." Staff's reply brief, p. 22. This is, Staff continues, consistent with a long line of previous Commission orders, including those issued in Cases Nos. U-14347, U-14547, U-15244, U-15245, and U-15645. Id. The Attorney General supports the Staff's proposed disallowance, noting--among other things--that "the majority of the benefits cited by Mich Con [as arising from the EICP] are benefits to its shareholders and not benefits to its ratepayers." Attorney General's initial brief, p. 29.

Mich Con objects to this proposed disallowance on the grounds that, not only are they properly recoverable (as evidenced by the fact that some other state commissions regularly allow their recovery), but that testimony offered in this case indicates that the Company "provided a detailed description of the customer benefits associated with each component of incentive compensation." Mich Con's reply brief, p. 51. In support of this assertion, the Company offers arguments to the effect that various aspects of the EICP have (1) increased employees' cash flow management through "expense control, timely accounts receivable collection, and tightly managed capital expenditures," (2) used "direct customer feedback to identify opportunities to address customer concerns," and thus improve service and reliability, (3) reduced the number of customer complaints, and (4) reduced the number of workplace injuries, as well as their attendant costs. Id.,

p. 51-52. At a minimum, the Company contends, it should at least receive partial recovery of its EICP costs in recognition of those ratepayer-friendly factors. Finally, Mich Con asserts that nowhere does the record indicate that the overall level of compensation (including all EICP costs) provided to its employees is unreasonable or imprudent, and that it would "not be able to attract and retain a highly-skilled workforce" were it precluded from compensating its workers at that level. Id., p. 52.

Notwithstanding Mich Con's arguments, the Commission has long indicated that, at least in Michigan, utilities would bear a substantial evidentiary burden should they seek to recover incentive-based compensation expenses from their ratepayers. Most recently, and with regard to Mich Con's sister utility, the Commission stated:

> Detroit Edison's principal argument on this issue appears to be that many other state commissions authorize recovery of some, or all, of employee incentive compensation expense. This is not the standard that the Commission looks to in making the determination whether the cost of an EICP is just and reasonable. The Commission has consistently required that a company proposing incentive compensation recovery in rates must quantify that the benefits to customers are greater than the costs of the program. Again, the EICP proposed by Detroit Edison is 50% focused on metrics that improve the financial position of the company and DTE shareholders, but do not provide direct benefits to ratepayers. Even those aspects of the EICP that are tied to ratepayer interests require the company to do little more than meet the requirements of Commission service quality rules.

January 11, 2010 order in consolidated Cases Nos. U-15768 and U-15751, pp. 48-49. Here, no true quantifiable data has been produced to show that the value of benefits received by ratepayers meets or exceeds the cost of the EICP. Moreover, while the utility's customers may indeed benefit when it meets some of the program's stated goals, many of the goals included in Mich Con's EICP parallel requirements already imposed by the Commission's Service Quality and Reliability Standards. Thus, as the

Commission recently found with regard to Detroit Edison, Mich Con's EICP does not appear to provide additional benefits justifying cost recovery. The ALJ therefore recommends that the Commission adopt the position advocated by the Staff and the Attorney General, and deny recovery of these costs.

3. CTA/PEP Expenses

During 2006, Mich Con filed an application--in Case No. U-14909--seeking various accounting approvals related to implementation costs arising from its PEP program (an intensive, enterprise-wide review of all of its operations). According to the utility, the purpose of the PEP was to go above and beyond what would normally be considered typical on-going operating improvement measures. As Mich Con indicated in that request, the PEP was designed to be consistent with the Company's cost effectiveness, customer service enhancement, and operations reliability and performance efforts. In total, Mich Con claimed, its PEP focused on all areas of the utility's operations in an effort to find ways to improve service while reducing cost.

On September 12, 2006, the Commission approved a settlement agreement that allowed Mich Con to defer and amortize--over a 10-year period--the incremental expenses arising from its CTA for implantation of its PEP. In approving that agreement, the Commission indicated that "[t]he reasonableness and prudence of actual PEP costs will be addressed in subsequent rate proceedings." September 12, 2006 Commission order in Case No. U-14909, p. 2. In the present case, the Staff's overall operating expense figure incorporates "all CTA for its PEP because the PEP savings exceeded the CTA costs." Staff's reply brief, p. 26. Mich Con supports the Staff's proposed recovery of these costs, in part due to its agreement with the Staff that "PEP savings far exceed PEP CTA." Mich Con's initial brief, pp. 67-68. Specifically, the Company noted that its customers "will realize a net benefit of approximately $41 million in the projected 2010 test year," as well as "a net benefit during the amortization period." Id., p. 68 (citing 5 Tr 917-918; Exhibit A-10, Schedule C13).

The Attorney General disagreed, and advocated disallowing the deferred and amortized CTA expenses, alleging that--at least from this point onward--the benefits of the program are outweighed by the costs to the utility's ratepayers. Citing testimony offered by Mr. Coppola, he based this recommendation on the belief that "the Company has already more than recovered . . . the CTA costs incurred to achieve the cost savings," and that allowing any future recovery would simply provide "a duplicative benefit to the Company and its shareholder," DTE. Attorney General's initial brief, p. 19 (citing 6 Tr 1625).

The ALJ disagrees with the Attorney General, in significant part, and finds that the amount of CTA/PEP expense recovery currently proposed by the Staff and supported by Mich Con should be approved in this case. As noted by the Company, it appears that the Attorney General inaccurately assumes that, at least historically, the utility itself experienced superior earnings as a result of PEP savings. This assumption conflicts with the fact that, as noted by Mich Con, its "average return from 2006 through 2008" (when the PEP was being actively pursued) was only 10.3%, despite the fact that its authorized rate of return throughout that period was 11%. See, Mich Con's reply brief, p. 56 (citing 5 Tr 998-999). Nevertheless, as noted by the Staff, "the increasing costs of the program are starting to mitigate its benefits." Staff's reply brief, p. 26. The ALJ thus recommends that, in addition to allowing recovery of these cost in the context of this rate case proceeding, the Commission require Mich Con to file (as part of its next general rate case application) a detailed cost/benefit analysis of the CTA/PEP on a going-forward basis.

4. Uncollectible Expense and the UETM

Consistent with both GAAP and the Commission's Uniform System of Accounts (USoA), uncollectible expense is recorded in a utility's income statement to reflect the portion of current sales revenue that is not expected to actually be recovered. As noted by the Company, the booked income effect of uncollectible expense is determined by using a calculation that assesses the future write-off potential of accounts receivable, plus any accounts written off, minus recoveries for the period, plus any low-income matching funds received. See, Mich Con's initial brief, p. 54. In general, the Commission has relied on the average net write-offs from the prior three years to determine what level of uncollectible expense should be included in the rate-setting process.

According to Amy M. Walt, DTE's General Manager of Revenue Management and Protection-Strategy, Mich Con's overall level of uncollectible expense over the last three years for which it had actual data increased from "approximately $74 million in 2006 to $126 million for 2008." 5 Tr 795. Moreover, she indicated that the average annual net write-off for that period was approximately $69.9 million. See, 5 Tr 801; Exhibit A-10, Schedule C5.8. Based on Ms. Walt's testimony, Mich Con proposed using that figure as a proxy for the Company's 2010 test year uncollectible expense. None of the parties objected to that figure's use, and thus the Staff included it in its calculation of overall O&M expense $69.9 million of uncollectible expense.

Nevertheless, significant opposition was expressed to the Company's request for authority to continue using the UETM approved in its last rate case, albeit with two changes (specifically, allowing the new $69.9 million base level to be implemented prospectively from the date of the final order in this case, and authorizing the utility to use the prior year's actual sales and transportation volumes by rate schedule to calculate the surcharge for each rate). Namely, MCAAA and ABATE contend that because Act 286 essentially gives Mich Con the opportunity to file a new rate case each year, the justification for adjustment or tracker clauses like the UETM has been greatly reduced. See, MCAAA's reply brief, p. 6. This is, they continue, especially true if the Company's pending request to establish an RDM is approved. See, Id.; ABATE's reply brief, p. 4. The Attorney General takes these contentions one step further, arguing that "the Commission lacks the statutory authority to authorize such a tracking mechanism." Attorney General's reply brief, p. 25.

Additionally, these three intervenors, plus the Staff, assert that even if Mich Con's UETM is allowed to continue, numerous changes are necessary. The Staff advocates adopting a UETM similar to that approved for use by Consumers in consolidated Cases Nos. U-15645 and U-15768, [30] which would--among other things--replace the current 90/10 recovery structure with one that assigns only 80% of the unrecovered charges to ratepayers, and which (as Mich Con does not seem to oppose) ties the UETM surcharges or credits assigned to each rate class to "the percentage of uncollectible

[30] Although the Staff initially suggested calculating the UETM's carrying charges in the same fashion as that adopted for application by Consumers (which uses the utility's short-term borrowing rate for underrecoveries and its authorized rate of return for overrecoveries), it ultimately elected to support the Company's proposal to continue applying symmetrical carrying charges (based solely on Mich Con's short-term borrowing rate) for all UETM balances. See, Staff's initial brief, p. 54. None of the other parties oppose using symmetrical carrying charges.

expense allocated to each rate class in the cost of service study utilized in the final rate design." Staff's initial brief, p. 54 (citing 6 Tr 1787). All three of the intervenors support switching to the Staff's proposed 80/20 structure, at least as a back-up plan. Additionally, MCAAA suggests (1) that the reconciliation of Mich Con's UETM should "compare the reconciliation test year net write-offs of uncollectible accounts with the base amount of net write-offs" when calculating the level of over- or under-recovery, and (2) that the "roll-over of over/under recoveries" from one year to another be eliminated. MCAAA's initial brief, pp. 18-19.

The ALJ begins by finding that the Attorney General's initial assertion (to the effect that the Commission lacks authority to provide for the use of UETMs like that proposed in this case) is without merit. Although arguing that no statute gives the Commission explicit authority to implement tracking mechanisms such as this, the Attorney General fails to note that Michigan courts have specifically recognized the Commission's power to do so pursuant to its broad ratemaking authority. For example, the Michigan Court of Appeals rejected precisely the same argument offered here in Attorney General v Public Service Commission, 281 Mich App 545; 761 NW2d 282 (2008), a case in which the Michigan Supreme Court ultimately denied leave to appeal. See, i.e., 483 Mich 1017 (2009).

Moreover, and notwithstanding various intervenors' assertions to the contrary, the ALJ finds that it still makes at least some sense to let Mich Con continue using a UETM. As noted by both Ms. Walt and Daniel G. Brudzynski, DTE's Vice President of Regulatory Affairs, Mich Con's uncollectible expense is effected by many factors that are outside the Company's control, such as the unemployment rate for those working and/or residing within its service territory, potentially volatile natural gas prices, the level of low-income funding available to its ratepayers, and general economic conditions. See, 5 Tr 799 and 955. The Commission's apparent recognition of such factors has led to its recent approval of UETMs for both Consumers and Detroit Edison. See, the Commission's November 2, 2009 order in Case No. U-15645, pp. 54-57, and its January 11, 2010 order in Cases Nos. U-15768 and U-15751.

In light of these findings, the focus turns to which features should be included in the UETM authorized for use by Mich Con as a result of this proceeding. Based on the briefs submitted by the parties, there appears to be no dispute regarding two areas. First, the Company, the Staff, and MCAAA all expressly agree that the 2010 UETM base should be set at $69.9 million and implemented prospectively from the date of the Commission's final order in this case (see, Mich Con's reply brief, p. 57; Staff's initial brief, p. 54; MCAAA's initial brief, p. 17), and none of the other parties object. Second, although there initially was a difference of opinion regarding whether asymmetrical carrying charges might be more appropriate, both Mich Con and the Staff now agree that symmetrical carrying charges (using the Company's short-term borrowing rate for both under- and over-recoveries) should be applied to any UETM balances, and that the prior year's actual sales and transportation volumes by rate schedule should be used when calculating the surcharge or credit for each rate.[31] See, Mich Con's reply brief, pp. 57-58; Staff's initial brief, p. 54. Again, none of the other parties object to making future UTEM-related calculations in this manner.

[31] The Staff's witness on this area, Poornima Jayasheela, also recommended calculating the UETM surcharges and credits for each rate class based upon the percentage of uncollectible expense allocated to the rate class in the cost of service study utilized in the final rate design arising from this case. Because none of the parties appear to disagree with this recommendation, and because it seems eminently reasonable, the ALJ recommends that the Commission adopt Ms. Jayasheela's proposal.

However, two areas of dispute do exist regarding the mechanism's specific structure. First, although the Staff, MCAAA, ABATE, and the Attorney General all assert that the Company should be held responsible for 20% of its net uncollectibles (as opposed to the 10% assigned under the previously-approved UETM), Mich Con objects to raising that percentage. Although conceding that the UETMs recently approved for use by Consumers and Detroit Edison (in Case No. U-15645 and consolidated Cases Nos. U-15768 and U-15751, respectively) were based on an 80/20 sharing of risk, Mich Con argues that structural differences between it and those two electric utilities, as well as the heightened impact that assigning the Company 20% of the risk of non-recovery would have on its return on equity, justify retaining the current 90/10 split. Second, Mich Con takes issue with MCAAA's proposal to (1) use actual net write-offs, instead of the Company's actual recorded uncollectible expense, when performing the annual UETM reconciliation, and (2) eliminate the roll-over of the resulting over- or under-collections into subsequent years. According to Mich Con, net write-offs "are a poor measure of the revenue in the annual period that will not be collected," and therefore would not accurately reflect the Company's actual expense during the period being reconciled. Mich Con's reply brief, p. 61. Moreover, it contends that the existing recovery process "is not overly complicated, and the benefits, if any, of eliminating roll-overs would not compensate for the loss of accuracy." Id. (citing 5 Tr 993).

The ALJ finds unpersuasive Mich Con's argument in opposition to adopting a 80/20 risk-sharing structure for its UETM. As asserted by the other parties, and as specifically noted by MCAAA's witness, William A. Peloquin, assigning the Company only 10% of the risk "does not provide an adequate incentive [for Mich Con] to hold down uncollectible expense." 6 Tr 1536. As MCAAA correctly points out, despite being faced with a huge increase in bad debt expense in 2008, Mich Con did not significantly increase its spending on revenue protection or revenue collection. See, MCAAA's initial brief, p. 15 (citing 5 Tr 804). Instead, the Company actually reduced the number of projected "cut and caps for non-payment" from 6,000 customers in 2009 to only 2,000 in 2010. 5 Tr 815. The ALJ therefore finds that assigning the utility 20% of the risk of non-payment is necessary to create an incentive, on the Company's behalf, to take all reasonable steps to reduce the level of its uncollectibles.

Nevertheless, the ALJ agrees with Mich Con regarding the need to use its actual recorded uncollectible expense, as opposed to net write-offs, when undertaking the UETM reconciliation. As noted above, the Company's actual annual uncollectible expense is recognized and recorded pursuant to GAAP and the Commission's USoA. Moreover, and as Mich Con correctly notes, this accrual for uncollectibles expense "provides an accurate matching of revenues and expenses in each annual period," whereas net write-offs merely constitute "the accounts receivable that, having exhausted all collection efforts, are deemed to not likely be collected." Mich Con's reply brief, pp. 60-61. Finally, the ALJ also agrees with the Company's assertion that the existing process of rolling-over UETM over- or under-collections to subsequent years is not overly complicated, and that little benefit would arise from its elimination. As a result, the ALJ finds that MCAAA's two above-mentioned proposals should be rejected.

Based on these multiple findings, the ALJ recommends that the Commission authorize Mich Con to continue operating its UETM, albeit with the recommended changes discussed previously.

5. LIEEF Costs

In connection with authorizing Mich Con to implement its UETM in the utility's prior general rate case, the Commission ordered the Company to include in its next rate case filing a proposed LIEEF program, the costs of which were to be recovered in base rates. See, April 28, 2005 order in Cases Nos. U-13898 and U-13899, pp. 74 and 99. However, when preparing and filing its current application, Mich Con concluded that seeking rate recovery of a LIEEF program was not appropriate "due to factors that the Commission did not contemplate." Mich Con's reply brief, p. 57. According to the Company, these were: (a) the fact that, at the time of its filing in this case, the low-income energy resources task force established in Case No. U-15918 was still in the process of developing recommendations; (b) its concern that recently-enacted 2008 PA 295, which provided for the establishment of Energy Optimization (EO) plans, might render a separate LIEEF program duplicative; and (c) the fact that the "economy had deteriorated significantly" since the issuance of the order directing the development of a LIEEF program. Id., fn. 51 (citing 4 Tr 251-252).

Nevertheless, the Staff felt that nothing occurring since the issuance of the prior rate case order relieved Mich Con of its duty to include such a program as part of its filing in this proceeding. Thus, as mentioned earlier, the Staff's proposed overall operating cost figure for the 2010 test year included approximately $5 million of O&M expense to support a LIEEF program, the primary objective of which was to have all customer classes fund shut-off protection for low income-customers. See, 6 Tr 1752-1754; and Exhibit S-3, Schedule C-5, line 28. For its part, MCAAA also strongly advocated the immediate establishment and funding of a LIEEF program like that proposed by the Staff. See, MCAAA's initial brief, pp. 12-13, and 6 Tr 1546-1547. Ultimately, Mich Con elected to support the Staff's proposal to add $5 million of LIEEF program costs to the utility's projected 2010 test year O&M expenses. See, Mich Con's reply brief, p. 57.

In contrast, both the Attorney General and ABATE contend that a legal question exists regarding whether the Commission currently has the necessary statutory power to impose LIEEF costs on other ratepayers in order to subsidize low-income customers. Although conceding that he and ABATE unsuccessfully raised the same legal question in the context of Case No. U-14547, and further noting that the Court of Appeals upheld the Commission's ruling in In re Application of Consumers Energy, 279 Mich App 180, 756 NW2d 253 (2008), the Attorney General asserts that a significant change in the law has occurred that "requires reconsideration of the Commission's statutory authority to impose LIEEF charges upon ratepayers." Attorney General's reply brief, p. 3. Specifically, he and ABATE assert that the Legislature's recent passage of Act 286 amended MCL 460.10d, effectively removing all previously-existing language that allowed for the authorization of LIEEF charges, and that although deliberations leading up to that amendment considered adopting a state-wide LIEEF factor as part of Senate Bill 216, that bill ultimately did not pass.

The Attorney General and ABATE thus argue that the Legislature's removal of the language that had previously provided for LIEEF programs, when coupled with its failure to enact language like that found in Senate Bill 216, deprived the Commission of clear statutory authority to require ratepayers to fund LIEEF operations. For his part, the Attorney General contends that the Commission cannot "ignore the amendment to

MCL 460.10d and conclude that the deletion/omission of language regarding the LIEEF was inadvertent." Id., p. 4. As for ABATE, it claims that "any vestige of statutory authority" for including LIEEF funding in utility rates has "disappeared." ABATE's reply brief, p. 6. These two intervenors therefore request that the $5 million of LIEEF funding advocated by the Staff, MCAAA, and Mich Con be removed from the overall O&M expense figure proposed for adoption in this case.

The ALJ is not persuaded by the arguments offered by the Attorney General and ABATE. As pointed out on page 25 of the Staff's reply brief, the Commission recently addressed this very issue in the context of its decision in Detroit Edison's most recent rate case. In so doing, the Commission began by noting that, "since the enactment of Act 286, the Legislature has twice referenced the LIEEF in subsequent bills that were signed into law." The Commission's January 11, 2010 order in Cases Nos. U-15768 and U-15751, p. 52. The first was 2009 PA 130, which contained a specific appropriation of $90 million for the "low income and energy efficiency fund," while the second, 2009 PA 172, directed that all civil fines ordered for violating certain municipal shutoff restrictions be "deposited in the low income and energy efficiency fund." Id. As a result, the Commission concluded that:

> The primary goal of statutory interpretation is to ascertain and give effect to legislative intent. Casco Twp. v. Secretary of State, 472 Mich 566, 571; 701 NW2d 102 (2005). The Commission finds that, as Detroit Edison pointed out, the elimination of Section 10d(6) by the Act 286 amendments merely removed a portion of the statute that was no longer relevant to funding of the LIEEF. Nevertheless, the Legislature has evinced a clear intent to continue the LIEEF by continuing to appropriate funds for the program and by the passage of Act 172 that provides an additional source of funding for the LIEEF. The Commission therefore rejects the arguments raised by the Attorney General and ABATE, and approves $39,858,000 for funding of LIEEF.

Id., p. 53.

The above-quoted decision is both well-reasoned and directly applicable to the issue presented here. The ALJ therefore recommends that--for the reasons expressed by the Commission in Cases Nos. U-15768 and U15751--the $5 million of LIEEF funding advocated by the Staff, MCAAA, and Mich Con be included as part of the overall O&M expense adopted in this case.

6. RDM Pilot

In addition to the other, numerous true-up or tracking mechanisms proposed in this case, it has been requested that the Commission also authorize Mich Con to impose an RDM. This proposal springs from Section 89(6) of the Clean, Renewable, and Efficient Energy Act, 2008 PA 295 (Act 295), which states, in pertinent part, that:

> The commission shall authorize a natural gas provider that spends a minimum of 0.5% of total natural gas retail sales revenues, including natural gas commodity costs, in a year on commission-approved energy optimization programs to implement a symmetrical revenue decoupling true-up mechanism that adjusts for sales volumes that are above or below the projected levels that were used to determine the revenue requirement authorized in the natural gas provider's most recent rate case. In determining the symmetrical revenue decoupling true-up mechanism utilized for each provider, the commission shall give deference to the proposed mechanism submitted by the provider. The commission may approve an alternative mechanism if the commission determines that the alternative mechanism is reasonable and prudent.

MCL 460.1089(6). As seems readily apparent from a full reading Act 295, the intent of this provision is to reduce or eliminate gas utilities' economic disincentive to having customers use natural gas more efficiently, thus making its easier for utilities, ratepayers, and the state to achieve the underlying, environmentally-based goals of Act

295.[32] In that regard, the proposals presented here would appear to serve a worthy goal, in that they all would allow the Company to at least recover the revenue it would have otherwise received had it not undertaken the EO activities called for under Act 295. Nevertheless, these proposals have led to several areas of dispute.

Mich Con's chief witness on this issue, Mark W. Stiers, offered what he called a "full revenue decoupling mechanism" (as opposed to an EO-only proposal), which the Company states would completely "remove the link between energy sales and utility revenues." Mich Con's initial brief, p. 74 (citing 4 Tr 236-237 and 263). According to Mr. Stiers, the utility's proposed RDM would serve:

> (1) to remove Mich Con's disincentive for promoting energy efficiency programs and conservation measures for our customers; (2) to address issues associated with collecting Mich Con's fixed cost of delivery service in the volumetric components of rates; (3) to address the impact of weather variability on the Company's temperature sensitive customers and its impact on the Company's financial performance; and (4) to address an anticipated loss of customers and the associated financial impact on Mich Con.

---

[32] Specifically, and as part of its "General Provisions," the purpose expressed in Section 2 of Act 295 reads as follows:

> (2) The purpose of this act is to promote the development of clean energy, renewable energy, and energy optimization through the implementation of a clean, renewable, and energy efficient standard that will cost-effectively do all of the following:
>
> (a) Diversify the resources used to reliably meet the energy needs of consumers in this state.
>
> (b) Provide greater energy security through the use of indigenous energy resources available within the state.
>
> (c) Encourage private investment in renewable energy and energy efficiency.
>
> (d) Provide improved air quality and other benefits to energy consumers and citizens of this state.

4 Tr 238. With regard to its specific structure, he continued, the Company would file an application with the Commission by the end of March each year that reconciles the utility's actual non-gas sales revenue for the previous calendar year with the corresponding non-gas revenue reflected in the Company's last general rate case. According to Mr. Stiers, that reconciliation would be performed by rate schedule and, after "notice, hearing, and a Commission order," Mich Con would implement rate schedule-specific credits or surcharges to collect any computed revenue surplus or shortfall. 4 Tr 242. This witness went on to state that Exhibit A-17, Schedule J1, sets forth the rate adjustment calculations required by the Company's proposed RDM.

Mich Con's second witness concerning this issue was Russell A. Feingold, an expert in the area of revenue decoupling. Based on his review of the Company's proposed RDM, he found it to be "fair, symmetrical, and beneficial to the utility and its customers." 5 Tr 1429. Mr. Feingold further explained that Mich Con's proposal is "conceptually consistent with the [RDMs] of other gas distribution utilities that are currently in effect," and that it "incorporates many of the key design elements" that he would expect to see in this type of ratemaking mechanism. Id. In light of this testimony, Mich Con seeks authority to implement the RDM described by Mr. Stiers.

As for the Staff, it began by recognizing that the Commission recently approved two RDM pilot programs, albeit both with regard to electric--as opposed to gas--utilities. As it noted, each of those RDMs (one of which was approved for Consumers in Case No. U-15645, and the other for Detroit Edison in Cases Nos. U-15768 and U-15751) was "based on a consumption-per-customer algorithm," and neither "used weather-normalized sales data" in their respective annual true-up proceedings. Staff's initial brief, p. 50. Nevertheless, the Staff asserted that "testing several different RDMs rather than approving an identical mechanism [for] all utilities," would likely prove beneficial to the Commission, at least during this pilot program period. Id. Thus, Robert G. Ozar, Manager of the Energy Efficiency Section of the Staff's Electric Reliability Section, proposed adopting--again, as a pilot program--an RDM that includes "an implicit customer tracker . . . using a straight revenue algorithm with weather normalization." Id. According to the Staff, such a mechanism could serve the dual purpose of reducing the frequency of rate case filings and providing the Commission with an opportunity to assess the merits of an RMD that reflects changes in the number of customers under real world conditions. The Staff also recommended that the Commission require Mich Con to "file a sales revenue decoupling true-up application within 120 days of the end of each 12-month period" in which the Commission-approved rates established in this proceeding have been in effect for 12 months, include a proposal for allocating any resultant surcharges or credits across customer classes, and provide for the continuing implementation of those surcharges or credits until such time that the Commission authorizes new surcharges or credits.[33] Id., pp. 51-52 (citing 6 Tr 1653).

---

[33] The Staff went on to note that the previously-approved RDMs for Consumers and Detroit Edison provided for a fixed 12-month reconciliation period. It therefore recommended that, "if the Commission likewise approves a fixed annual period for Mich Con in this proceeding," it should specifically "address the issue of how base revenues should be calculated in the circumstances wherein new rates are implemented prior to the end of the 12-month RDM reconciliation period." Staff's initial brief, p. 52. The Staff further suggested that:

> [T]here are certain concerns regarding the appropriateness of determining unrecovered revenue requirements during those earlier months in which rates wee established in a preceding rate case if the calculation used base sales levels and rates established in the most current rate case. In this circumstance, Staff maintains that it is necessary and appropriate to identify the base sales level for each of the months in the 12-month period that were approved in each respective rate case. These sales levels will then, in turn, be reconciled to the actual sales levels for each of the 12 months.

Id. (citing 6 Tr 1654-1655).

The Attorney General contends that, based on policy grounds alone, the Commission should either (1) refrain from authorizing any RDM for Mich Con or, (2) if it does authorize one, "at least adopt a form of revenue decoupling that is very limited in scope." Attorney General's initial brief, p. 9. According to him:

> Revenue Decoupling greatly reduces the business risk of Mich Con at a great cost to its customers. During a time of economic difficulty [and] with natural gas usage dropping, not because of energy efficiency, but because many customers simply cannot afford it, it makes little sense to add additional costs on customers as a result of their decision to cut back on heat for their homes. Such a mechanism could create a cycle of further reductions in natural gas usage as a result of yearly surcharges imposed by the mechanism. These yearly surcharges will further force customers to make additional reductions in their usage in order to make ends meet.

Id. Nonetheless, the Attorney General points out that Mich Con has taken an extraordinarily broad approach in designing its RDM to include the recovery of revenue loss for any reason, including lower sales not just from energy conservation, but from warmer-than-expected weather, loss of customers, and general economic downturns. According to his witness, Mr. Coppola, the Company's proposed RDM is so broad as to constitute "a guaranteed revenue program." Id., p. 10.

Moreover, the Attorney General continues, the extreme breadth of Mich Con's proposal places it in conflict with Act 295 itself. Specifically, he notes that Section 89(6) of Act 295 makes no explicit reference to the recovery of weather-related effects on sales and transportation volumes. Thus, the Attorney General contends, a "weather normalization clause" (which Mich Con's RDM proposal would effectively constitute) is clearly outside the scope of a statute "designed to promote energy conservation and allow for an RDM that recovers the effects of energy conservation on sales—not weather." Id. According to him, the same is true of any mechanism that would allow recovery for reductions in customer usage caused by something other than conservation. The Attorney General further asserts that, as stated by Mr. Coppola, authorizing a broad RDM “takes away any incentive for the Company to grow its gas markets,” which in turn can “create a dangerous downward spiraling effect with declining volumes and increasing rates if the Company has little of no incentive to retain sales and transportation load.” Id., p. 11 (citing 6 Tr 1607-1608).

For these reasons, the Attorney General recommends that, if the Commission does elect to authorize an RDM for Mich Con, several modifications must be made to the Company’s proposal. These recommended modifications include, among other things: (1) normalizing actual gas deliveries for the effects of weather, (2) separating large-volume transportation customers from all other rate classes and conducting a yearly survey to determine these rate classes’ average annual energy conservation rate, which would then be used to determine the degree to which their conservation efforts reduced Mich Con’s revenue, and (3) limiting the duration of any RDM surcharge or refund to one year. Id., pp. 12-13 (citing 6 Tr 1608-1611).

ABATE fully supports the Attorney General’s assertion that the RDM proposed by Mich Con is an attempt to protect the Company from risks well beyond those contemplated by Act 295. According to it, the revenue decoupling provision found in Act 295 was clearly intended to protect Mich Con and other gas utilities from lost revenues resulting from their EO programs. See, ABATE’s initial brief, p. 6. Nevertheless, ABATE continues, the Company seeks to recover not only EO-related lost revenues, but also “revenues lost because of weather or virtually any other reason, including lost customers, while keeping any increased revenue from new customers for Mich Con alone." Id. According to ABATE, the unfairness of the Company's proposal is made clear by Exhibit A-17, Schedule J, which (as noted by ABATE's witness, Mr. Selecky) demonstrates that:

> If there is a growth in a customer class, Mich Con will retain all of the revenue associated with the growth. However, if there is a decline in the number of customers in a class, Mich Con recovers that decline. Therefore, Mich Con will be able to recover revenue shortfalls due to loss of customers, but will retain all revenue associated with growth in the number of customers.

Id., p. 8 (citing 6 Tr 1564). For these reasons, ABATE contends that Mich Con's proposed RDM must be rejected.[34]

However, ABATE continues by arguing that should the Commission elect to adopt some RDM for use by the Company, the approved mechanism must eliminate sales impacts caused by weather or any cause other than Mich Con's approved EO programs. ABATE's initial brief, p. 8. Moreover, it contends, any such RDM "must be symmetrical and trued-up on the basis of class revenue." Id. Finally, ABATE asserts that the RDM should "exclude at least the Rate XLT and Rate XXLT customers" on the grounds that: (1) they do not represent a significant portion of Mich Con's non-gas revenues, (2) the Company's proposed transportation rates would let it recover 30% of the revenue from these customers through their respective customer charges, thus diminishing the need to include them in the RDM, and (3) the loss of even a few of these large-volume customers could, by causing an increase in the total charges assessed to others in the same rate class, lead the remaining members of those rate

[34] Based on its belief that the Staff's alternative RDM proposal is also too broad (notwithstanding its inclusion of weather normalization), ABATE recommends rejecting that proposal as well. See, ABATE's reply brief, p. 3.

classes to consider bypassing Mich Con's system altogether. Id. (citing 6 Tr 1564-1565).

Reading Act 295 as a whole does, in the ALJ's eyes, lead to the conclusion that the underlying intent of Section 89(6) was to hold gas utilities harmless for any sales lost as a result of their Commission-approved EO programs. Thus, left to my own devices, it would be easy to adopt the arguments offered by the Attorney General and ABATE regarding the advisability of limiting any recovery allowed under a utility's RDM to revenue lost exclusively from EO-related conservation. However, based on recent orders concerning Consumers and Detroit Edison, where the Commission clearly expressed its desire to gain experience with wider-ranging RDM pilot programs,[35] the ALJ feels constrained to reject the joint request of the Attorney General and ABATE to find that such a narrowly-tailored RDM should be authorized in this case.[36]

Nevertheless, good cause does exist for adopting a methodology that uses weather-normalized figures (which should also serve the purpose of narrowing the RDM's scope significantly). Although the Commission elected not to include weather normalization in either of the RDMs approved for Consumers and Detroit Edison, the sales levels for natural gas utilities (like Mich Con) are much more closely linked to weather variability than are electric utility sales levels. See, i.e., 6 Tr 1658. Moreover, and as noted by the Staff, using a weather-normalized RDM is advantageous because it results in "reduced rate volatility and [a] reduced magnitude of surcharge level." Staff's

---

[35] See, i.e., the Commission's November 2, 2009 order in Case No. U-15645, pp. 51-54; and its January 11, 2010 order in Cases Nos. U-15768 and U-15751, pp. 65-68.

[36] Although clearly implied by this finding, it bears stating that the ALJ is not persuaded that recommending the approval of no RDM whatsoever is a reasonable result. Section 89(6) of Act 295 appears to mandate the authorization of some form of RDM in this situation. As such, the ALJ finds that all arguments to the contrary must be rejected.

initial brief, p. 51. In this regard, Mr. Ozar used the following example to explain how a higher degree of rate volatility would result from using an RDM based on actual (non-weather adjusted) sales levels:

> For example, if in a given year, all other things being equal, Mich Con experiences a warmer-than-normal year, a surcharge would be calculated for a [RDM] reconciliation true-up. If the surcharge is implemented in a subsequent year, and that year is colder-that-normal, then customers will bear the combination of an increased level of monthly bills associated with the colder-than-normal weather, and the surcharge for the prior [RDM] reconciliation period. Conversely, if the true-up period was colder-than-normal, a negative surcharge (i.e., refund) would be calculated for the surcharge period. If that subsequent period was warmer-than-normal, then the combination would result in a large reduction in customer bills. The end result is more dramatic swings in customer bills as compared to a decoupling mechanism that reconciles weather-normalized revenues.

6 Tr 1658-1659. Finally, the ALJ finds that testing several different RDMs during the RDM pilot phase, as opposed to approving an identical mechanism for each and every utility in Michigan, could prove beneficial to the Commission (as well as the parties that come before it).

The ALJ therefore recommends that, of the two full RDM proposals offered in the present case, the Commission should adopt the Staff's weather-normalized mechanism. Doing so should ameliorate, at least in part, the underlying concerns giving rise to the intervenors' other proposed modifications to Mich Con's proffered RDM. Moreover, because it is also recommended that the Staff's proposal be adopted as an RDM pilot,[37] the parties and the Commission will have ample opportunity to evaluate the suggested modifications (such as ABATE's requested exclusion of XLT and XXLT customers, and

---

[37] Although ABATE asserts that due to Act 295's explicit authorization of RDMs for gas utilities, there is no need to "experiment" with regard to Mich Con's mechanism, the ALJ finds otherwise. As of this date, none of Michigan's regulated utilities have actually completed an RDM true-up and imposed the resultant surcharges or credits upon their customers. Until both the Commission and the interested parties have had an opportunity to see various RDMs function, it would behoove everyone to use the first generation of decoupling mechanisms as a learning experience, so to speak.

the Attorney General's request to use a survey to gather usage and conservation data from large-volume transportation customers) at a later time and with the benefit of real world experience.

7. Cost of Gas Sold

Mich Con's presentation regarding its estimated 2010 cost of gas sold was provided by Mr. Chapel. Among other things, that presentation indicated that the appropriate average cost of gas sold would be $7.59 per Mcf. See, 5 Tr 849. Staff agrees with that figure, and thus suggests using $7.59 per Mcf when computing Mich Con's overall company use[38] (CU) and lost and unaccounted for[39] (LAUF) gas expense.

Based on the lack of opposition by any of the parties to this proceeding, the ALJ agrees with Mich Con and the Staff, and recommends that the Commission adopt that figure.

8. CU, LAUF, and Gas-in-Kind [40](GIK) Percentages

Mich Con and the Staff differ significantly in their respective projections regarding the amount of--and thus the expense level to be assigned to--CU and LAUF gas for the 2010 test year. In addition, both the Staff and ABATE take issue with the GIK percentages that the Company proposed for adoption in this proceeding.

---

[38] "Company use" refers to volumes of gas that are (at least predominantly) related to fuel used to operate and maintain Mich Con's transmission and storage facilities, such as the gas used to operate the transmission system's compressors.

[39] "Lost and unaccounted for" gas represents the difference between the Company's booked cost of gas and its booked disposition of gas (much of which arises from small leaks or metering losses).

[40] "Gas-in-kind" is the volume of natural gas that Mich Con collects from certain customers as a way for them to pay their respective shares of the cost that the utility incurs for its own fuel use, metering losses, and leakage.

With regard to CU, Mich Con proposes a 2010 CU level of 2,538 Million cubic feet (MMcf), which it arrived at by taking its actual 2008 CU volumes, increasing them to reflect an assumed GIK offset, and then adding nearly 500 MMcf of what it considers known and measurable changes. See, Exhibit A-12, Schedule E13. According to the Company, the additional 500 MMcf of gas that it expects to use during the 2010 plan year relates to the amount of gas needed to run new compressors that were recently installed at both the Belle River storage facility and the Willow Gate Station, gas used to power the Belle River facility's new refrigeration unit, and gas needed to operate the Sumpter Pipeline's compressor. Mich Con's initial brief, p. 80. As for its prediction of test year LAUF gas levels, the Company proposed using "a straight five-year historical average of LAUF volumes, without application of the LAUF percent to projected throughput,"[41] which results in a figure of 6,447 MMcf. Mich Con therefore asserts that the total volume of CU and LAUF gas that should be used in setting its rates is 8,985 MMcf. When priced at the above-mentioned $7.59/Mcf cost of gas sold, the Company calculates its total CU/LAUF expense to be approximately $68,196,000.

The Staff disagrees with both the CU and LAUF volume levels advocated for use by Mich Con. According to Ms. Janssen, a more realistic level of CU for the utility's 2010 test year would be 1,987 MMcf, which is equal to its actual CU volumes for 2008. See, 6 Tr 1762. Despite the Company's claim that recent improvements to its Belle River, Willow Gate, and Sumpter facilities would likely increase its CU volumes (and, thus, its CU-related expenses), Ms. Janssen noted that similar system improvements over the past 10 years did not produce significant increases to Mich Con's annual CU

[41] Although its decision not to apply the LAUF percentage constitutes an apparent change in the usual calculation of LAUF volumes, Mich Con claims that this is necessary to reflect the fact that the relationship between LAUF and throughput volumes is no longer linear. Mich Con's initial brief, p. 81.

levels. See, Id. As for LAUF gas volumes, the Staff proposed a slightly higher number than the utility, specifically 6,836 MMcf. In advocating for the use of this figure, the Staff notes that it is equal to the utility's 5-year average of LAUF gas. See, 6 Tr 1764. Taken together, the Staff's total CU/LAUF volumes for 2010 would equal approximately 8,823 MMcf, which--when priced out at $7.95 per Mcf--results in just under $67 million in related expenses.

The ALJ finds that the Staff's proposed CU/LAUF level is more reasonable than that sponsored by the Company and, thus, should be used in setting Mich Con's rates. In reaching this conclusion, the ALJ notes that the CU figure offered by Mr. Jansen not only corresponds to the utility's actual level of CU for 2008, but also falls "approximately halfway between the high and low [CU] volumes over the past ten years." 6 Tr 1762; See also, Exhibit S-5, Schedule F-2-3, p. 1-4. Moreover, in addition to being slightly higher than Mich Con's proposed volumes, the Staff's recommended LAUF gas figure (namely, 6,836 MMcf) matches the five-year average recorded for the Company. See, 6 Tr 1764; Exhibit S-5, Schedule F-2-3, p. 4. The ALJ therefore recommends that the Staff's proposed total CU/LAUF volume of 8,823 MMcf, as well as its corresponding cost of $66,962,000,[42] be adopted for use in this case.

With regard to what GIK percentages should be established as a result of this proceeding, Mich Con proposes to "bifurcate the GIK percentage and create two GIK charges [for each customer class] based on the use of cost-causation principles to allocate LAUF to the customer classes creating the expenses." Mich Con's initial brief, p. 82. Under the Company's proposal, GIK recovery from off-system transportation and

[42] This figure is reflected on Exhibit S-3, Schedule C-1, line 6, column d, in the context of the Staff's computation of Mich Con's total net operating income.

storage customers would be 1.41%, while full system users--such as sales and EUT customers--would both be assessed 2.44%. See, Id. For its part, the Staff initially computed GIK percentages of 1.63% for off-system customers, 1.66% for sales customers, and 1.74% for EUT customers. See, Exhibit S-5, Schedule F-2-3. However, ABATE's witness, Mr. Selecky, noted an apparent error in the Staff's GIK percentage calculation. Specifically, he pointed out that the Staff neglected to include the Exelon-related gas volumes in its computations, thereby overstating the GIK percentage for EUT customers. 6 Tr 1577. Correcting for this error, Mr. Selecky continued, results in GIK recovery percentages of 1.63% for off-system customers, and 1.66% for both sales and EUT customers. Id. The Staff agrees with that proposed correction, and now both it and ABATE advocate adopting Mr. Selecky's proposed GIK percentages.

The ALJ finds that the revised GIK percentages computed by Mr. Selecky, and supported by both ABATE and the Staff, should be adopted in this case. A close analysis of the computations offered in this proceeding shows that the Company's figures were based (at least in part) on its higher projected level of CU/LAUF volumes, namely 8,984 Mcf, while those giving rise the GIK percentages proposed by Mr. Selecky were based on the Staff' lower CU/LAUF figure. See, Exhibit A-47, p. 3, line 3; Exhibit S-5, Schedule F-2-3, page 5. Because the Staff's CU/LAUF figure has previously been adopted in this PFD, the ALJ likewise recommends that the GIK percentages supported by ABATE and the Staff (specifically, 1.63% for off-system customers, and 1.66% for both sales and EUT customers) be adopted by the Commission.

9. Mich Con's Proposed LGTM

Mich Con contends that, over the last ten years, it's expenses associated with CU and LAUF gas have "never been recovered by the authorized level of recovery in the non-gas base rates and GIK" that it actually was able to collect. Mich Con's initial brief, p. 80. According to the Company, "this revenue shortfall is a major cause of Mich Con's inability to earn fair and reasonable returns," and is due to "(1) the volatility in the annual cost of gas rate; (2) the variability of the LAUF; and (3) declining throughput and sales markets." Id., pp. 80-81 (citing, 5 Tr 623-627). As a result, Mich Con proposes to implement an LGTM structured as follows:

> By November 30 of each calendar year, Mich Con would submit an application, as a continuation of this case, comparing its actual LAUF and CU gas for the year that ended August 31 to the base level of set in this case. There would be an opportunity for a hearing, and presumably narrow and prompt proceedings resulting in the difference between the base and actual amounts being collected from, or refunded to, Mich Con's customers through a temporary surcharge or credit. Any year-end over- or under-recovery, plus interest at Mich Con's short-term borrowing rate, would be the beginning balance for the next year of the program.

Mich Con's initial brief, p. 83.

The Staff, MCAAA, ABATE, and the Attorney General all oppose granting Mich Con's request to implement an LGTM. For example, the Staff contends--among other things--that "the enactment of Act 286 reduced Mich Con's risk of under-collection" to the point where the proposed LGTM has been rendered wholly unnecessary. Staff's reply brief, p. 39. Moreover, both MCAAA and ABATE essentially assert that, by providing Mich Con with "assured 100% recovery of all costs and losses covered by the clause (including gas losses and costs from gas leaks, gas theft, etc.)," the LGTM would destroy "any and all financial incentives for addressing and remedying those losses and costs." MCAAA's initial brief, p. 19; ABATE's initial brief, pp. 10-11. For his part, the Attorney General claims not only that the Commission "lacks the statutory authority to adopt such a tracking mechanism," but also that the Company's proposal should be rejected "on policy grounds." Attorney General's initial brief, p. 13. Specifically, he notes that:

> The [LGTM] eliminates the incentive for the company to reduce lost and unaccounted for gas and reduces the business risk of the company with no commensurate benefit to ratepayers such as a reduction in return on equity.

Id. The Attorney General thus argues that, based on five separate problems with the LGTM identified by his witness, Mr. Coppola, the Commission should reject Mich Con's proposed LGTM. Id., pp. 14-15.

The ALJ agrees with these arguments and finds that an insufficient basis has been provided for allowing Mich Con to implement its proposed LGTM. This finding is based primarily on two factors. First, as correctly noted by Ms. Janssen, the utility's risk of under-recovering its CU/LAUF expenses "has been greatly reduced" as a result of Act 286. 6 Tr 1769. As Ms. Janssen pointed out, Act 286 (1) permits the utility to file its rate case using projected, as opposed to historical, costs to support its particular rate request, (2) allows the Company, absent issuance of a Commission order ruling otherwise within 180 days of the utility's rate request, to self-implement whatever portion of a proposed rate increase it so desires, (3) essentially guarantees implementation of at least some portion of its rate request within 12-months of its filing, and (4) allows the utility to start the process all over again immediately upon issuance of the Commission's final order or 12-months after submission of its previous rate case application. See, Staff's initial brief, p. 55 (citing 6 Tr 1769-1770). Second, as asserted by MCAAA and supported by Mr. Peloquin, implementing the proposed LGTM could actually harm ratepayers by diminishing or eliminating Mich Con's incentive to reduce its annual LAUF levels, particularly with regard to gas theft. Specifically, Mr. Peloquin testified that:

> It is imperative that Mich Con successfully stop the expansion of its gas theft. Therefore, the Commission should seek to maximize Mich Con's financial incentive to fight this battle. Mich Con witnesses describe how this utility is <u>beginning</u> to address the serious threat of the gas theft movement. The Commission would not be helping Mich Con by approving a LGTM and thereby reducing the utility's financial incentive.

MCAAA's initial brief, pp. 20-21 (citing 6 Tr 1538-1539; emphasis in original). Based on these factors, the ALJ recommends that the Commission reject the Company's proposed LGTM.

10. <u>Mich Con and MCAAA Accounting Requests</u>

In the course of this proceeding, the Company sought explicit authorization from the Commission to either commence or continue taking certain actions with regard to various accounting practices. The four areas in which it seeks this specific approval are described, in detail, on pages 85 through 88 of its initial brief. Although not specifically commenting on those requests, the Staff has implicitly adopted several of them and included their effects in the ratemaking calculations depicted on Exhibit S-2, Schedule B-1 and Exhibit S-3, Schedules C-8 and C-9. Moreover, none of the parties objected to Mich Con's various accounting proposals.

As a result, the ALJ recommends that the Commission specifically grant the accounting authority requested by the Company with regard to the four areas described on pages 85 through 88 of Mich Con's initial brief.

However, Mich Con was not alone in seeking some form of accounting-based relief in this case. Rather, MCAAA requested that the Commission commence a process to facilitate having Mich Con convert from its currently-adhered-to “last in first out” (LIFO) method of accounting for its booked cost of gas to either “first in first out” (FIFO) or average cost inventory accounting. In support of that request, MCAAA contends that: (1) on an overall basis, the use of LIFO accounting has increased Mich Con’s cost of gas and, correspondingly, Mich Con’s GCR rates, and has also increased the volatility of both its gas costs and GCR rates; (2) the use of LIFO accounting has created a large “latent windfall,” financed by ratepayers and represented by the difference between Mich Con’s booked cost of gas in storage as compared to the market value of that gas; (3) the use of LIFO accounting “isolates Mich Con as the only gas utility in Michigan using LIFO accounting,” thus making benchmarking comparisons more difficult; (4) LIFO accounting “creates mismatches between Mich Con’s use of a calendar year for financial reporting purposes compared to its use of an “operational year” for purposes of GCR cases; and (5) the growing likelihood that the federal Securities and Exchange Commission will adopt the International Financial Reporting Standards--or, IFRS--relatively soon enhances the need for Mich Con to switch out of LIFO accounting, as those standards do not recognize LIFO accounting. MCAAA’s initial brief, pp. 1-2. MCAAA therefore requests that the Commission order Mich Con to undertake “an in depth study” of all issues relating to the potential switch from LIFO to either FIFO or average cost inventory accounting, establish a collaborative process for addressing this issue, and require Mich Con to present the results of the study as part of its next general rate case filing. Id., p. 11.

Mich Con objects to the MCAAA’s proposal on several grounds. Among these are that the Commission has rejected identical proposals in the past, the Company’s use of LIFO inventory accounting does not actually increase the cost of gas (and, instead, benefits customers by sending them accurate price signals in a timely manner), and that adopting MCAAA's suggested accounting change "threatens significant financial impacts, without any tangible benefit or other justification." Mich Con's initial brief, p. 89. As such, Mich Con argues, the Commission should reject all of MCAAA's requests concerning the possibility of changing from LIFO inventory accounting to some other methodology.

Although finding at least some validity to the concerns expressed by MCAAA, the ALJ is persuaded by the arguments offered by Mich Con. First, as correctly noted by Mr. Rynearson, assertions to the effect that LIFO accounting results in higher GCR factors are "only true in a constantly rising cost environment," and that "in a declining price environment, gas costs are lower under LIFO than would be the case under either FIFO or Average Cost inventory accounting methods." 4 Tr 434. Second, by providing "timelier price signals to customers than other methods of inventory accounting," the LIFO methodology benefits ratepayers by giving them "an opportunity to change behavior (i.e., conserve energy) during periods of higher gas prices." 4 Tr 433-434. Third, both Mr. Rynearson and MCAAA's witness--Mr. Peloquin--agree that having Mich Con switch to either FIFO or average cost inventory accounting would have a significant countervailing effect on the utility's base rates. Specifically, they point out that such a change would substantially raise the value of gas in storage, thereby dramatically increasing the working capital component of rate base (and, with it, the utility's overall revenue requirement). See, 4 Tr 434; 6 Tr 1541-1542. Fourth and finally, it is unclear when and if IFRS will be imposed upon Mich Con, and whether or not such imposition would specifically require a switch from LIFO accounting. See, 4 Tr 473-475. Thus, although this matter is worth monitoring, and while it may make sense to undertake a collaborative process to consider how all of Michigan's various utilities can best respond to whatever changes may be required by implementation of the IFRS, it appears that too much uncertainty presently exists to justify immediately initiating such a process.

For these reasons, the ALJ recommends that the Commission refrain from imposing the accounting-related requirements sought by MCAAA, at least at this point in time.

11. Taft-Hartley Training Trust Fund

Local 223 generally supports Mich Con's rate increase request. Much of that support, it appears, is based on the fact that the Company included as part of its projected 2010 test year expenses $28,725,843 in safety and training costs. See, Exhibit UWU-8, p. 5. According to Local 223, such spending is vitally necessary to address the crisis of Mich Con's aging workforce and the coming shortage of well-trained workers. For this and other reasons, the union requests that the Commission require Mich Con to establish a Taft-Hartley Training Trust that would specifically set aside funds for worker training. It further requests that the Commission order the Company to file a report "outlining its plans to address the imminent crisis presented by its aging workforce, including its plans with respect to recruitment and hiring, as well as training," and an estimate of anticipated costs associated with those activities. Local 223's brief, p. 2.

Local 223 presented the testimony of Richard Mata, National Director of Training for the Utility Workers Union of America, in support of its various requests. Relying on demographic information compiled by the union and reflected on Exhibit UWU-9, he testified that:

> Of the 943 gas workers [currently] at Mich Con, 748 workers are age 40 and older, representing 79% of the workforce; 502 workers are age 50 and older, representing 53% of the workforce; 319 are age 55 and older, representing 34% of the workforce; and 129 are age 60 or older, representing 14% of the workforce.

Based on this information and the weighted average retirement age of 60 (as reflected on Exhibit UWU-10), Mr. Mata stated that "it is reasonable to conclude that a significant percentage of Mich Con's aging organized workforce will be retiring in the next several years." 4 Tr 569.

Mr. Mata also sponsored (among other documents) Exhibit UWU-5, which is the 2006 United States Department of Energy report to Congress required by the Federal Energy Policy Act of 2005. He further testified that this report--like others provided by the union--reflects an identical concern with respect to the aging of the workforce necessary to service and operate the nation's utility systems. Mr. Mata went on to state that the report "highlights and demonstrates the crisis of the aging utility workforce, both nationally and at Mich Con, and the need for increased training to ensure reliability and quality of service, as well as public and worker safety." Id. However, Mr. Mata expressed concern that the funds Mich Con is seeking for workforce training in this case are not dedicated or otherwise protected for the purpose of training and, instead, are subject to the general discretion of the Company. See, 4 Tr 570. This is particularly troubling, he continued, in light of Mich Con's specific request to cease providing (as part of its UETM true-up case filing) annual reports supporting the Company's actual level of safety and training O&M expense as compared to the amount reflected in its revenue requirement.[43] Id.

Local 223 argues that the Commission has both the statutory authority and the duty to ensure worker safety and system reliability and, consequently, it possesses the power to order Mich Con to participate in a Taft-Hartley Training Trust. In making this argument, the utility contends that the Michigan Supreme Court's ruling in Union Carbide v. Public Service Comm, 431 Mich 135 (1988), does not override the Commission's authority to ensure worker safety and system reliability. Rather, it notes, Union Carbide involved efforts by the Commission to require Consumers to void commercial contracts for the supply of oil entered into with Union Carbide, and further notes that the Court held that the Commission did not have the power to order the cessation of "non-economic management practices," although it did have the power to preclude rate recovery of the increased charges incurred as a result of those contracts. According to Local 223, the statutory mandates with respect to worker safety and system reliability are not "management practices" and are a far cry from an attempt by the Commission to void commercial contracts.

Based on that analysis, Local 223 states that the $28,725,843 Mich Con proposes to spend on safety and training during 2010 represents "a reasonable set aside for placement into the UWUA Power for America Taft-Hartley Training Trust for the training of Mich Con's gas workers." Local 223's brief, p. 9. Finally, it notes that both Detroit Edison (in Cases Nos. U-15768 and U-15751) and Consumers (in Case

[43] Mich Con's request to cease filing these reports, which were required pursuant to the ruling on pages 74 through 76 of the Commission's April 28, 2005 order in Cases Nos. U-13898 and U-13899, was expressed by Mr. Brudzynski (as reflected on 5 Tr 962), as well as on page 71 of the Company's initial brief.

No. U-15645) were recently directed to file a report evaluating future training needs, including the amount of its budget presently devoted to training, its estimated future training costs, and the potential costs and benefits to the utility and the public of a ratepayer-funded training trust. Although continuing to advocate for external funding of training costs via use of a trust, Local 223 agrees that such a report should be ordered in this proceeding, albeit expanded to detail:

> [the Company's] plans for the next five years as to how it intends to address its demographic crisis, including its specific plans as to recruitment and hiring (as well as training) of the skilled workforce [needed] to safely and reliably supply natural gas to its customers.

Id., pp. 13-14. Moreover, it asserts that Mich Con should be required to continue submitting its annual report on safety- and training-related expenses in connection with its EUTM filing, as was ordered in Cases Nos. U-13898 and U-13899.

The Staff concurs that "funds should be specifically set aside by the Company, and monitored, exclusively for the purposes of training." Staff's reply brief, p. 40. Although apparently stopping short of recommending the immediate placement of such funds in an outside trust, the Staff supports Local 223's request to have the Commission direct Mich Con to:

> file in this docket, within 90 days of the date of its final order, a report evaluating its present and expected future training needs, the amount of its budget presently devoted to training, its estimated future training costs, and the potential costs and benefits to the utility and public of a ratepayer-funded training trust.

Id. Moreover, the Staff also contends that information concerning the Company's recruitment, hiring, and training plans regarding workers involved in system safety and reliability constitutes relevant information that should, as Local 223 requests, be included in that report. Id., p. 41.

Mich Con responds that it recognizes the need for training and is committed to providing appropriate funding to maintain a highly-skilled workforce that provides safe and reliable gas service to its customers. However, the Company disagrees with assertions that some sort of training trust is either necessary or appropriate. According to the utility, it has budgeted for and is seeking an appropriate amount of money for safety and training, and Local 223 does not disagree with its requested level of funding. Although Local 223 expresses concern about the utility's potential exercise of discretion in spending funds, the Company points out that it has "never cited any instance where Mich Con has misspent any funds" or provided "any other tangible reason to now establish a trust." Mich Con's reply brief, p. 81.

The Company further responds that Local 223's argument that the Commission has implied authority to order the Company to participate in a training trust is far from compelling. In Mich Con's view, there is no credible issue regarding safety or reliability relative to the union's request. Essentially, the Company asserts, Local 223 "wants the Commission to dictate a management decision for Mich Con, which the Commission lacks the authority to do" in light of Union Carbide, supra.

Moreover, Mich Con contends that in the event that the Commission orders issuance of a report (which the utility denies would be appropriate), that document should be limited to the same type of report that was recently required of both Consumers and Detroit Edison. According to the Company, there is no reason to place any additional burden on it, and the record fails to provide adequate grounds for expanding Mich Con's required filing to cover the issues of future recruitment and hiring. Mich Con's reply brief, pp. 82-83.

In both its November 2, 2009 order in Case No. U-15645 and its January 11, 2010 order in Cases Nos. U-15768 and U-15751, the Commission addressed the same issue relative to Consumers and Detroit Edison, respectively. In each instance, the Commission was apparently convinced that the coming shortage of trained workers is a critical problem that must be addressed. However, it also appears to have concluded that the legal question of whether a trust can be established outside of a collective bargaining agreement had not been adequately addressed by the parties. As a result, the Commission—again, in both instances--directed the respective utility to file a detailed report regarding its proposed workforce training. Moreover, in Detroit Edison's case, the Commission elected not to adopt the union's request to expand the required report to include information concerning future recruitment and hiring plans. See, January 11, 2010 order in Cases Nos.U-15768 and U-15751, at pp. 69-71.

As in the two above-cited cases, the evidence shows that a significant portion of Mich Con's aging workforce will be retiring in the next several years. However, the legal question of whether the Commission can require the Company to participate in an external trust with its organized workers has again not been sufficiently addressed by the parties. The ALJ therefore recommends that, consistent with its recent orders concerning Consumers and Detroit Edison, the Commission direct Mich Con to file in this docket, within 90 days following the date of its final order, a report evaluating its present and expected future safety and training needs, the amount of its budget presently devoted to that issue, its estimated future costs, and the potential costs and benefits to the utility and the public of a ratepayer-funded training trust. Moreover, consistent with the Commission's directives in the two above-cited orders, the ALJ also recommends rejecting Local 223's other forms of requested relief.

12. Michigan Business Tax Expense

Mich Con contends that the Staff's overall operating cost figure is understated by $1,847,000 due to an error in the amount of Michigan Business Tax (MBT) expense included in that figure. As noted in rebuttal testimony provided by Joann Chavez, DTE's Vice President and Chief Tax Officer, the Staff's computation failed to "use the revised Business Income Tax Base to recalculate the Business Income Tax Loss Carry-forward," and mistakenly included "the tax adjustment for AFUDC Equity . . . in both the temporary differences and the permanent differences reported on Exhibit S-3, Schedule C-9, lines 15 and 16." 5 Tr 1472. The Staff reviewed this matter and now agrees with Mich Con's position. See, Staff's initial brief, p. 30. None of the other parties take issue with the Company's calculation.

As a result, the ALJ finds that Mich Con's request to increase the Staff's proposed overall operating expense figure by $1,847,000 should be granted.

13. Base Operating Expense Summary

In light of the above discussion, the ALJ recommends that the Commission adopt, for purposes of computing Mich Con's adjusted net operating income, a total base operating expense figure of $607,355,000 (computed by adding the $1,847,000 MBT adjustment to the Staff's initial overall expense figure of $605,508,000).

D. Miscellaneous Adjustments

Three additional adjustments are needed to compute the Company's adjusted net operating income. The first reflects the tax effect on the interest implicit in the utility's capital structure and the second recognizes the tax consequences of interest synchronization. Together, these two adjustments decrease Mich Con's total operating expense (and therefore increase the Company's adjusted net operating income) by approximately $2,078,000. The third adjustment, which reflects a $29,000 reduction in AFUDC arising from the use of a 10.50% return on common equity, reduces Mich Con's adjusted net operating income by an identical amount.[44]

E. Computation of Adjusted Net Operating Income

Based upon the discussion set forth above, the ALJ recommends finding Mich Con's adjusted net operating income to be $77,880,000. This figure is computed as follows:

Total Operating Revenue	$683,186,000
Total Operating Expense	(607,355,000)
Interest Implicit in Capital Structure and Interest Synchronization	2,078,000
Cost of Capital Effect on AFUDC	(29,000)
Adjusted Net Operating Income:	$ 77,880,000

VI.

REVENUE DEFICIENCY

Once Mich Con's total rate base, overall rate of return, and adjusted net operating income have been determined, the computation of the Company's projected 2010 revenue deficiency (which the ALJ finds to be approximately $142,888,000) is relatively straight-forward. The computation of this figure is as follows:

[44] Specifically, reducing the cost of common equity/authorized rate of return to 10.50%--from the Staff's proposed level of 10.85%--reduces AFUDC by $29,000 (from $1,497,000 to $1,468,000).

Rate Base	$2,361,145,000
Overall Rate of Return	x 6.99%
Income Required	$ 165,044,000
Less: Adjusted Net Operating Income	- 77,880,000
Income Deficiency	$ 87,164,000
Revenue Multiplier	x 1.6393
Revenue Deficiency	$ 142,888,000

VII.

COST ALLOCATION, RATE DESIGN, AND TARIFF ISSUES

Having established Mich Con's expected revenue deficiency for the projected 2010 test year, the Commission must now allocate costs and design rates to eliminate that deficiency. Moreover, it must also develop tariff language that is both reasonable and equitable. Mich Con, the Staff, ABATE, and Constellation all offered testimony and exhibits regarding these matters, and what follows is a discussion of the pertinent issues remaining in dispute.

A. Cost Allocation

1. Cost-of-Service Studies (COSS)

In the present case, both Mich Con and the Staff offered full COSS as the starting point for cost allocation. The utility's witness on this issue, Thomas W. Lacey, actually provided two separate studies, one covering the 2008 historical test year (set forth on Exhibit A-6, Schedule F6.1) and the other covering the 2010 projected test year (received as Exhibit A-13, Schedule F1.1 [Revised]). Ms. Janssen provided the Staff's COSS, which is set forth as Exhibit S-5, Schedule F-6. These parties acknowledge that their respective COSS are essentially the same, and that they generally applied the same basic principles that were adopted by the Commission in Mich Con's most recent rate case. See, Staff's initial brief, p. 33; 5 Tr 1299-1300.

Nevertheless, one important area of difference was noted with regard to these studies. Specifically, Mich Con pointed out that, primarily due to its use of actual 2008 peak day throughput instead of design peak day volumes, the allocation factors resulting from the Staff's COSS would shift "approximately $7 million of cost of service from sales to transportation customers." Mich Con's initial brief, p. 90. Based on rebuttal testimony provided by Mr. Lacey, where he explained that use of the utility's "Design Peak is the method adopted by the Commission in the last two Mich Con General Rate Cases," the Company asserts that its COSS should be adopted for use in this proceeding, as opposed to that offered by the Staff. 5 Tr 1316. ABATE agrees with that assertion.[45]

The ALJ agrees with Mich Con and ABATE on this point. As specifically noted by the Company's witness, the Commission's final order in a prior Mich Con rate case supported the joint Mich Con/ABATE argument that:

> use of a design peak day is better than a historic peak day for the allocation of costs because (1) use of a design peak day figure better reflects the costs of the system as constructed, (2) actual peak day is "randomly based" on weather experienced on a single day during the historic test year, and thus may not be reflective of future peak day usage,

[45] In doing so, however, it should be noted that ABATE is not wholly enamored with Mich Con's COSS and the cost allocation factors arising from it. Rather, as asserted by its witness, Mr. Selecky:

> In my opinion, Mich Con's [COSS] over-allocates costs to transportation customers. . . . Mich Con's study is based on the "peak and average" allocation method, which allocates a significant portion of fixed, demand related cost on the basis of throughput. It is more appropriate to allocate the investment in mains on the basis of peak day demands.

6 Tr. 1558-1559. Nevertheless, based on the recognition that Mich Con's COSS should lead to transportation customers receiving a rate increase that is "significantly below the system average increase," ABATE elected not to offer its own peak day demand-based COSS for use in this case. See, ABATE's initial brief, p. 4.

> and (3) use of a design peak day figure better reflects the utility's need to ensure uninterrupted service even on the coldest day of the year.

5 Tr 1316-1317 (citing the Commission's October 28, 1993 order in consolidated Cases Nos. U-10149 and U-10150, at p. 90). The ALJ thus recommends that the Commission adopt Mich Con's COSS as a starting point for cost allocation in this proceeding, but with all modifications necessitated by other findings set forth in this PFD.

2. Residential Income Assistance (RIA) Credit

One potential modification to Mich Con's proposed allocation of the costs approved for recovery in this case springs from the Staff's proposal to eliminate the current Rate AS Low-Income Senior Citizens Winter Credit of $11.00 and replace it with an RIA Credit of $6.00 per month. According to the Staff's witness with regard to this issue, Mr. Revere:

> The proposed RIA Credit will be available to all of the customers who formerly received the Low-Income Senior Citizen Winter Credit. Though only half as large, the RIA Credit will be received in all months rather than [only] for 4 months in the winter. This means customers who qualify for the credit will receive a $72.00 credit annually instead of $44.00.
>
> * * *
>
> Staff believes that the current state of the economy in Michigan, coupled with the rate increase proposed in this case, will place an undue burden on low-income households. The proposed RIA Credit will help mitigate the effects of the proposed rate increase for the Company's most vulnerable customers.

6 Tr 1856-1857. Mich Con has not expressed opposition to making this change,[46] and none of the other parties object. The ALJ thus finds that the Staff's proposed RIA Credit should be adopted in place of the current winter-specific credit.

[46] See, Mich Con's initial brief at pp. 90-91, and its reply brief at p.85.

Nevertheless, the Staff and Mich Con do disagree regarding how to allocate the estimated $13 million revenue shortfall arising from the RIA Credit's implementation. The Staff recommends spreading that shortfall to all rate classes, "to remain consistent with the new requirements for electric utilities' low-income rates in Act 286," and further proposes that the shortfall "be spread on the basis of test year throughput." Staff's initial brief, p. 37 (citing 6 Tr 1851-1852). In contrast, Mich Con contends that the shortfall should be recovered exclusively from the Company's residential class because the costs being allocated are classified as residential in the COSS, as well as the fact that such treatment would be consistent with that accorded the previously-existing low-income credit. Mich Con's reply brief, p. 85. The Company further asserts that if the Commission nevertheless elects to spread that recovery to all rate classes, the allocation should be accomplished on the basis of Allocation Factor No. 20 (cost of service plus cost of gas), as is done for uncollectible expense.

The ALJ agrees with the Staff on the first of these issues, and finds that the shortfall arising from the RIA Credit should be spread to all rate classes, as opposed to residential customers only. Although the pertinent provisions of Act 286 only require this of electric utilities, no justification has been offered for treating gas customers different from electric customers in this regard. As for the second issue, however, the ALJ agrees with Mich Con and finds that recovery of the $13 million shortfall should be assigned on the basis of Allocation Factor No. 20, as opposed to throughput. As correctly noted by Mr. Lacey:

> Throughput should only be used for minor costs or costs that vary based upon customer usage such as fuel costs. Clearly, the $13 million RIA credit is not such [a] cost. Allocation Factor No. 20 (Cost of Service plus Cost of Gas) which is used to allocate uncollectibles to all rate classes is a

> more suitable basis for allocating the RIA credit than throughput. Uncollectibles [expense] is more analogous to the RIA credit than fuel.

5 Tr 1315. The ALJ therefore recommends that, in addition to adopting the RIA Credit as a replacement for the Company's current winter-specific low-income credit, the Commission should both (1) require the shortfall arising from the RIA Credit to be spread to all rate classes, and (2) require that this be done through the use of Mich Con's Allocation Factor No. 20.

3. Proposed Residential-to-General Service Shift

A second potential modification to Mich Con's proposed cost allocation arose from the Company's proposal to shift $12 million of cost recovery from its Rate A (i.e., residential) customers to its Rate GS-1 and GS-2 (i.e., non-residential general service) customers. According to Mich Con, "the shift is necessary to avoid an increase for Rate A customers that is substantially greater than the increase for Rate GS-1 and GS-2 customers. Mich Con's reply brief, pp. 86-87. In light of its preference for "cost based rates for natural gas service," as well as its expectation that the RIA Credit would be approved in this case, the Staff advocated against the Company's proposed reallocation of these costs. Staff's reply brief, p. 28.

Notwithstanding the Staff's opposition, the ALJ finds that Mich Con's proposal is reasonable and should be adopted in this case. As noted by Mr. Lacey, "it is common practice to redistribute [rate] increases to accomplish social benefits or recognize gradualism." 5 Tr 1308. Here, the record indicates that residential customers would, under a strict application of cost-of-service principles, be faced with significantly higher rate increases than general service customers would be required to bear. Because it appears that the Company's suggested transfer of this amount of cost recovery would still leave residential customers with larger expected rate increases (at least on average) than their general service brethren, the ALJ recommends that the Commission approve Mich Con's proposal.

4. Cost Allocation to Large Volume Transportation Customers

The next suggested change to Mich Con's cost allocation was offered by ABATE, who essentially asserts that although the Company's proposal would move its large volume transportation customers much closer to cost-of-service-based rates, these customers' deserve to have their rates moved "to" cost of service. ABATE's brief, p. 5. Specifically, ABATE contends that despite computing the cost of service for these customers (who currently take service on Rate XLT and may shift, in some cases, to Mich Con's proposed Rate XXLT) to be $19,881,000 for the 2010 test year, the Company proposes recovering $20,650,000 from them. ABATE therefore contends that, based on true cost-of-service principles, the Commission should require Mich Con to revise its cost allocation structure to reduce the allocated recovery from these customers by the $769,000 difference between those figures.

Once again, the ALJ finds Mich Con's proposed allocation to be reasonable. As noted by Mr. Lacey, the specific allocation of costs assigned to these large-volume EUT customers was prompted by the need to maintain the respective economic breakeven points between all of the various transportation customer classes, running from the Company's ST and LT classes, on the smaller end, to its XLT and (proposed) XXLT customers, on the larger side. See, 5 Tr 1306 and 1218. Moreover, and as noted earlier (i.e., in the context of footnote 43) the transportation customers in question are already in line to receive a rate increase substantially lower than the system average increase. Thus, the theory of gradualism again supports the Company's cost allocation plan. For these two reasons, the ALJ recommends that the Commission accept Mich Con's proposed cost allocation as it pertains to its XLT and (potential) XXLT customer classes.

5. Rate Treatment of the Exelon Contract

During its review of the proposed merger between DTE and MCN, the Federal Trade Commission (FTC) expressed concern that the merger could reduce competition within the overlapping service territories of Detroit Edison and Mich Con (generally located in the greater Detroit and Ann Arbor areas). As noted by Mich Con's witness on this matter, Mr. Brudzynski, the FTC Staff:

> was concerned that Mich Con's practice of offering discounts and other promotional activities to incent gas distribution customers where on-site electric generation equipment was a viable option in the overlap area would not be offered subsequent to the proposed merger. In order to address the FTC Staff's concern and to further encourage the installation of on-site electric generation, and more generally to promote competition between natural gas and electricity in the overlap territory after the proposed merger, Mich Con entered into a contract with Exelon. . . . The special contract granted Exelon a recognized property right to pipeline capacity on Mich Con's distribution system, thereby giving Exelon the ability to directly compete in the overlap area with services offered by Mich Con.

5 Tr 966. Mr. Brudzynski went on to state that, at present, Exelon has exercised its right to purchase 6 MMcf of capacity on Mich Con's system for an annual capacity charge of $4.45 million. See, 5 Tr 967. Although Mich Con's COSS indicated that the cost of service for that 6 MMcf of pipeline capacity would total $4.9 million, the Company proposed allocating the $450,000 underrecovery arising from its contract with Exelon "to all rate groups in proportion to standard rate delivery volumes." Mich Con's reply brief, p. 87. According to the Company, this proposed treatment is justified

because, among other things (1) its agreement with Exelon is in the form of an easement, as opposed to a special contract (which would fall under the relatively strict cost/benefit analysis noted in earlier in this PFD), and (2) it allows customers to negotiate delivery service at competitive rates and terms, while also encouraging gas-fired electric generation, and thus reducing the need to purchase electricity from out-of-state generators. See, Mich Con's initial brief, pp. 92-93; and 5 Tr 969-970.

The Staff objects to Mich Con's proposed allocation of the Exelon contract's underrecovery to other ratepayers, as well as its attempt to portray this agreement as something that was entered into exclusively for the benefit of its customers. According to the Staff, the agreement constitutes a special contract and, because the Company has failed to meet the Commission's previously delineated prerequisites for recovery of any revenue shortfall, the $450,000 underrecovery should not be allocated to the utility's other ratepayers. Moreover, the Staff asserts that the Exelon agreement benefited only the Company's corporate parent--by allowing DTE to conclude its merger with MCN--and merely provides Mich Con's ratepayers with something that already existed before the agreement, namely the possibility of competition between Detroit Edison and Mich Con in the overlapping service territory. It therefore argues that the Commission should "adopt Staff's treatment of the Exelon agreement, which is consistent with the Commission's prior determinations regarding ratepayer recovery of discounted contracts." Staff's reply brief, p. 32.

The ALJ finds Staff's arguments persuasive on this issue. As it correctly notes, the Exelon contract was put in place solely to allay the FTC staff's concerns regarding the anti-competitive effect that the DTE/MCN merger could have (particularly with regard to potential gas-fired electric generation by third party generators) in the overlapping service territory. See, 6 Tr 1851. Thus, as pointed out by Mr. Revere:

> [T]he competition the Exelon agreement is responsible for is not so much a benefit to other ratepayers as it is a way of maintaining the competition that existed before MCN and DTE merged. . . . [T]his does not represent a benefit to ratepayers that can be attributed to the Exelon contract, as the benefit claimed by the Company existed before the Exelon contract [was signed]. . . . Therefore, the Company's argument that the Exelon contract represents a substantial benefit to ratepayers through promotion of competition should be rejected.

Id. Moreover, Mich Con's claim that the agreement represents an easement and thus falls outside the strict cost recovery requirements applied to special contracts must be rejected. The Commission order approving the Exelon contract specifically stated that:

> If Mich Con seeks to increase other customers' rates as a result of the contract, it is on notice that the principles discussed in the March 23, 1995 order in Case No. U-10646 and the October 25, 1995 order in Case No. U-10961 should apply.

February 14, 2001 order, Case No. U-12825, p. 4. The principles referred to by the Commission were that, in order to collect any underrecovery arising from a special contract such as this, the utility would "bear a substantial burden" that:

> would require, at a minimum, a clear, convincing, and unequivocal demonstration either (1) that the contract prices and terms are justified on the basis of the cost of service, or (2) that the benefits for other (non-participating) ratepayers are substantial and have a value that outweighs the costs that are not recovered from the contract customer.

Id., (citing the Commission's March 23, 1995 order in Case No. U-10646, p. 21). Here, Mich Con's own COSS reflects that revenues from the contract do not cover its fully-assigned costs, and the Company has failed to show that the agreement provides substantial benefits to other ratepayers. The ALJ therefore recommends that the

Commission direct Mich Con to modify its cost allocation to include the Staff's proposed treatment of the Exelon contract.

6. XXLT/DIG Rate

As has been alluded to earlier, Mich Con proposed to establish a new "Double Extra-Large Transportation Service Rate - XXLT" for use by its largest EUT customers, specifically those using over 3.5 Bcf per year. Moreover, based on its annual projected usage of 8.6 Bcf, Mich Con noted that DIG would qualify this tariff. As a result, in performing its cost allocation, the Company assumed that the XXLT rate would be allowed to take effect and that DIG would take service under that tariff. Although the Staff agreed that Mich Con needs an XXLT rate, as did both ABATE and Constellation, the Staff treated that proposed rate class differently for purposes of its COSS than did the Company. Specifically, it assigned $19,300,000 of distribution plant costs and $704,000 in distribution operating expense to the XXLT, while excluding DIG from its cost of service and cost allocation calculations for that proposed tariff.

However, after further review of this apparent conflict, the Staff has reached the conclusion that Mich Con's treatment of the XXLT/DIG Rate class is appropriate and that the above-mentioned distribution costs should not be allocated to these customers. See, Staff's reply brief, p. 32. Moreover, the Staff now agrees that, "to the extent that this means the rates DIG takes, or will take, service under are designed to recover the cost of service to DIG and the other customers in the rate class, there will be no [special contact] discount." Id., p. 33.

Nevertheless, one related area of dispute has arisen. Specifically, in its initial brief, ABATE raised for the first time the possibility of requiring Mich Con to "develop and implement a transportation rate for those customers who take service directly from the transmission [as opposed to distribution] system." ABATE's initial brief, p. 6. Mich Con opposes that request on the grounds that it (1) overlooks valuable components of the utility's existing service, such as load balancing storage, delivery point flexibility, and month-end balancing, and (2) could actually serve to promote bypass of the Company's system. Mich Con's initial brief, p. 96. The Staff also opposes adopting ABATE's request. Although stating that "this proposal may have merit," the Staff correctly notes that no evidentiary record was developed to support the adoption of such a request, and thus recommends that it be rejected for the time being. Staff's reply brief, p. 33.

The ALJ agrees with the Staff. It is therefore recommended that the Commission adopt both Mich Con's proposal to establish the XXLT/DIG rate and the Company's proposed cost allocation for that new rate class, but that it not order Mich Con to immediately develop and implement the additional transportation rate requested by ABATE.

B. Rate Design

Mich Con and the Staff followed essentially the same rate design methodology, designing rates that maintain the breakeven points between individual rate schedules and retain historical parity, while also ensuring that each rate class--in total--recovers its allocated revenue requirement. See, 6 Tr 1855-1860; 4 Tr 1235-1238. Although variations in certain charges do exist, those are caused (at least to significant degree) by the substantial difference in the size of the revenue deficiency that these two parties assumed when assembling their respective rate design proposals. Moreover, many of the parties' suggested changes to Mich Con's rate schedules either (1) were not contentious from the start, (2) have subsequently been resolved by the parties, sometimes by express agreement, and other times through a party's apparent decision to abandon its initial objection, or (3) have been implicitly approved or rejected based on earlier rulings contained in this PFD--i.e., adoption of the Staff's proposed RIA Credit, rejection of Mich Con's proposal to adopt bifurcated GIK percentages, etc. What follows is a brief analysis of those remaining areas where significant dispute still exists.

1. Customer Charges/Distribution Rates – Sales

With regard to residential Rates A, AS, and 2A-Meter Class 1, Mich Con and the Staff agree that the monthly customer charge for each class should be increased from \$8.50 to \$11.00.[47] They further agree that the volumetric distribution charges for these and all other sales rate classes should be established at whatever level is necessary to recover the remainder of their allocated costs, beyond the revenue derived from the customer charge. However, with regard to Rate 2A-Meter Class 2 and Rate GS-1, Mich Con proposes increasing the customer charge from its current level of \$20 to \$30, whereas the Staff' recommends increasing it only to \$25.[48] Similarly, although the two parties strove to maintain the breakeven point between the GS-1 and GS-2 rate classes, the Company recommended increasing Rate GS-2's customer charge from its current \$475 per month to \$700, whereas the Staff proposed increasing it to only \$505.[49] Finally, with regard to schools taking service on Rate S, Mich Con proposed a customer charge of \$300 per month, while the Staff recommended imposing \$200 instead.

[47] See, 5 Tr 1235-1236; 6 Tr 1855-1856.

[48] See, Id.

[49] See, 5 Tr 1238; 6 Tr 1859.

The ALJ agrees with Mich Con and the Staff regarding the propriety of increasing the monthly customer charge for Rates A, AS, and 2A-Meter Class 1 to $11.00. As for the remaining sales rate classes, the ALJ finds that the Staff's lower customer charges proposed for each should be adopted. Because the differences between the levels proposed by the Company and the Staff appear to be driven largely by their respective assumptions concerning the size of the revenue deficiency ultimately established in this case, and because the Staff's suggested revenue deficiency figure more closely matches the level recommended by the ALJ, the Staff's customer charges appear more reasonable. The ALJ therefore recommends that the Commission adopt the Staff's recommended customer charges for each sales rate class, and direct the parties to compute the corresponding volumetric distribution charges following issuance of the Commission's final order in this proceeding.

2. Customer Charges/Distribution Rates -- Transportation

With regard to the Company's EUT rates, Mich Con and the Staff again agree on the need to set rates in such a way that will maintain the economic breakeven points between the various classes. However, as with several of the sales rate classes, these parties differ with regard to where to set the respective monthly customer charges, with Mich Con generally proposing larger monthly charges (albeit with lower distribution rates) than those recommended by the Staff. Specifically, the Company's proposed transportation customer charges were $2,400 for Rate ST, $4,000 for Rate LT, $18,000 for Rate XLT, and $115,000 for newly-established Rate XXLT. See, Exhibit A-13, Schedule F2 [Revised]. In contrast, the Staff recommended monthly charges of $1,570 for Rate ST, $4,590 for Rate LT, $13,130 for Rate XLT, and $18,730 for Rate XXLT. See, Exhibit S-3, Schedule F-4-4 [Revised].

For the same general reasons expressed with regard to sales rates, The ALJ recommends that the Commission adopt the Staff's proposed monthly customer charges for each of these four EUT rate classes, and again direct the parties to compute the corresponding volumetric distribution charges for each class following issuance of the Commission's final order.

3. Load Balancing Storage Charge

Although Mich Con proposed several changes to both its sales rate schedules and its transportation and storage rate schedules (as described on pages 93 through 95 of its initial brief and pages 88 through 90 of its reply brief), only one suggested modification garnered any opposition. Specifically, the utility's proposal to alter the language of its load balancing storage charge was questioned, at least in part, by Constellation's witness, James R. Germain.

As discussed by Wayne E. Fox, its Manager - Gas Major Accounts, Mich Con wants to extend the storage injection limitation period found in Paragraph C of its Load Balancing Storage Charge, thus adding the month of November to the period during which the utility's end-use transportation customers are barred from injecting more than 1.43% of their respective annual contract quantity into load balancing storage.[50] According to Mr. Fox, extending the period covered by this limitation from two months (namely, September and October) to three is necessary to "ensure proper, safe, and

[50] Although the Company also sought Commission approval to "round the current rate for the Load Balancing Storage Charge . . . from $0.246 per MMBtu to $0.25 per MMBtu," no opposition was expressed with regard to that change, thus justifying its approval. 5 Tr 1206.

reliable control of [Mich Con's] system and to maintain the integrity, flexibility, and access to its system for all customers." 5 Tr 1205.

Mr. Germain took issue with this request on the grounds that the Company failed to provide any support for its claim that extending the injection limitation period was necessary. Rather, he asserted that, based on information received from Mich Con, none of the utility's end-use transportation customers had injected any gas into storage during November of 2006, 2007, or 2008. 4 Tr 331. Thus, he recommended rejecting this proposed tariff change.

The ALJ disagrees and finds that the proposed extension of the storage injection limitation period is adequately supported on the record, and should be adopted by the Commission. As specifically noted by Mr. Fox:

> While the months of September and October are critical to procuring and storing gas for the GCR customers, the month of November has become critical as well. Since EUT customers balance on a monthly basis, they can inject substantial quantities during the first half of November when Mich Con's storage balances are near or at their maximum physical capacity limits.

5 Tr 1205. This witness went on to state that:

> Mich Con's most recent experience in November 2009 perfectly demonstrates the importance of implementing this requirement. Significantly warmer than normal temperatures in early November combined with low EUT [customer] consumption resulted in EUT injections during the first twelve days of the month. As operator of the system, Mich Con is proposing the extension of the injection limitation period to include November as a means to protect system integrity by ensuring that EUT customers coordinate their gas supplies to match the operations of the system.

5 Tr 1254. Based on this testimony, the ALJ concludes that the Commission should approve the proposed tariff change requested by the Company.

4. <u>Gas Customer Choice (GCC) Tariff Change</u>

The Staff proposed modifying Mich Con's GCC tariff by adding, as part of Section F1 – General Provisions, the following sentence:

> If a Customer is in arrears with the company, the customer is not eligible to participate in this customer choice program until arrearages have been paid in full to the company.

6 Tr 1780. According to the Staff, this recommended change "is reasonable, and by imposing this limitation, Mich Con's uncollectible [expense] for a given year will be minimized." Staff's initial brief, p. 49.

Mich Con opposes adding this provision to its GCC tariff. Specifically, the Company asserts that the Commission should not consider this proposal at this time because (1) the GCC program is voluntary, (2) the Company accepted many changes to the program's structure in the context of Case No. U-15929, (3) such a change would result in additional costs to Mich Con, and (4) it is unnecessary. <u>See</u>, Mich Con's reply brief, pp. 97-98, fn. 68. Although expressing appreciation for the Staff's "desire to propose a provision to mitigate customer arrearages," Mich Con doubts that the Staff's proposed tariff change "will influence any customer to become current on their bills (thereby reducing Mich Con's uncollectible expense) in order to switch to a GCC supplier." <u>Id</u>. (citing 5 Tr 1242-1244).

The ALJ agrees with Mich Con on this issue. While it is critically important for Mich Con to take all reasonable steps to reduce the level of its uncollectibles expense, it is indeed doubtful that a customer's desire to participate in the GCC program would provide adequate incentive to immediately pay its outstanding arrearages. Moreover, as noted by the Company's witness on this issue, Mr. Fox:

> Mich Con's treatment of arrearages and collection status is the same for both GCR and GCC customers. A GCR customers with an arrearage who switches to GCC supply still has an arrearage and their collection status is the same. For example, if [customers have] a $100 arrearage and they switch to choice, they still have a $100 arrearage. Similarly, if a customer is scheduled for shutoff on the 23rd of a particular month and that customer switches to GCC on the 21st, the customer will still be subject to shutoff on the 23rd if they have not paid their arrearage.

5 Tr 1244. Because it is unlikely that the Staff's language would provide more incentive for customers to become current on their bills, the ALJ finds insufficient reason for adopting the proposed change, and recommends that Commission reject that proposal.

5. Pooling

Constellation's involvement in this case was, by a wide margin, focused primarily on the asserted need for "pooling," which it described as getting Mich Con to "change its operational rules to allow suppliers to combine their transportation customers into groups or pools." Constellation's initial brief, p. 2.[51] According to Constellation's Vice President of Supply, Mr. Germain, pooling is--at its most basic level--"simply the grouping together of transportation service customers that are all being supplied by the same marketer." Id. Arguing that pooling is a "common industry practice" followed by several utilities in Michigan, Constellation requests that the Commission:

> (1) Require that the Company accept pooled nominations from marketers (Germain Direct, pp. 21-22; Tr 347-348);
>
> (2) Modify Mich Con's tariff to assess charges, including local balancing charges, authorized and unauthorized gas usage charges, and charges, surcharges, fees, or penalties based on the net imbalance of a marketer's pool (Germain Direct, pp. 21-24; Tr 347-350); and

[51] It bears noting that, on March 30, 2010 (six weeks after the deadline for filing reply briefs in this proceeding), Constellation submitted a document entitled "Supplemental Authority of Constellation NewEnergy, Inc.," to which it attached part of the PFD issued in Case No. U-15986--Consumers' ongoing gas rate case. Because this filing was made well beyond the consensus schedule established for the present case, and because that PFD's discussion of pooling is grounded upon what must be viewed (at least in the context of this case) as extra-record evidence, neither Constellation's tardy filing nor any subsequent filings submitted in response to it have been considered in preparing the current PFD.

> (3) Implement pooling of transportation customer storage and require that pool monthly injection rights are established based upon the pool member's individual tariff rights (Germain Direct, pp. 21-24; Tr 347-350).

Id., p. 3.

In support of this request, Mr. Germain testified that pooling simplifies the transportation service procedures for a marketer, thus promoting efficiencies, reducing administrative burdens, and reducing the costs associated with a utility's provision of transportation service. See, 4 Tr 338. Moreover, he continued, it allows for the netting of various transportation customers' individual gas imbalances, thus reducing the level of balancing fees and cash-out charges that would otherwise be paid to the utility. See, Id., at 339. According to Mr. Germain:

> The impact of pooling is that "the utility only recovers the cost of actual imbalances on its system created by the customers in the pool; the utility no longer benefits from mathematical imbalances that do not result in actual physical imbalances on the utility system.

Id., p. 341. Thus, Constellation asserts, "pooling not only reduces the administrative costs of a marketer, it also reduces the balancing charges" arising from the imbalances themselves, "thereby directly reducing the cost of transportation service for customers." Constellation's initial brief, p. 5 (citing 4 Tr 341).

Mich Con objects to Constellation's pooling proposal, arguing that it is nothing more than "a self-serving effort to reduce administrative burdens and costs for gas marketers," all the while serving "to the detriment of Mich Con and [its] customers." Mich Con's initial brief, p. 97. In support of this argument, the Company cites testimony from Mr. Fox to the effect that the alleged justifications for Constellation's proposal are both "irrelevant and misleading." Id. Specifically, Mr. Fox asserts that, for all of the benefits that a pooling arrangement would likely provide marketers like Constellation, it would require:

> significant restructuring of Mich Con's contractual terms and conditions with existing customers, and also require Mich Con to enter into contracts with marketers. Additionally, Mich Con would be required to track pool activity, and make software coding changes to its nomination and billing systems.

5 Tr 1255. Moreover, he testified, Constellation's proposal would have a detrimental impact on transportation and storage customers. Specifically, Mr. Fox noted:

> Currently, [Mich Con's] EUT customers have the flexibility to purchase supply from multiple marketers, and may switch marketers at any time. Under [Constellation's] proposal, this flexibility would have to be eliminated in order for the utility to accurately track pool transactions on behalf of the marketer. Overall, [Constellation's] pooling proposal highlights the benefits for the marketer but does not quantify the benefits for the customer or discuss how costs associated with Mich Con's increased administrative burden and system modifications would be recovered. Ultimately, these costs would result in higher customer rates—an outcome [Constellation] seems to have ignored.

Id. For these and other reasons, Mich Con contends that Constellation's pooling proposal must be rejected.

The only other party to weigh in on this issue was the Staff, who generally agreed with the points raised by Mich Con. Although conceding that Constellation's proposal "would undoubtedly benefit the marketers on Mich Con's system," the Staff was unable to discern exactly "how these changes would truly enhance the current system in place for Mich Con's transportation customers." Staff's reply brief, p. 34. Rather, it concluded that while Constellation's proposed tariff changes would greatly aid marketers like itself, their overall effect would ultimately be to the detriment of transportation customers. See, Id. Although noting that four gas utilities in Michigan do allow for some degree of pooling, the Staff points out that those utilities (1) require daily balancing of their EUT customers' gas supplies, (2) are significantly smaller than Mich Con, and (3) run their operations much differently than the Company, particularly with regard to cash-out mechanisms, nominations, and the imposition of balancing charges. See, Id., p. 35. In contrast to the daily balancing requirements imposed by those other, smaller local distribution companies, the Staff points out that:

> Mich Con's transportation program . . . only requires its customers to balance [their respective] supplies and usage on a monthly basis with a Maximum Daily Quantity (MDQ) based upon the customer's peak monthly use plus 10%, [and makes] this peak month MDQ available each month except during the injection limit periods. . . . Thus, because Mich Con's transportation customers do not have to balance their gas supplies daily, they do not need a pooling service for operational purposes. The transportation customers also have the ability to change their nominations on a daily basis.

Id. (citations omitted). As a result, the Staff recommends that Constellation's pooling proposal not be included in the tariff changes adopted as a result of this case.

The ALJ agrees with Mich Con and the Staff, finds that adoption of Constellation's proposal is not adequately supported by the record, and recommends that the tariff changes necessary to implement such a proposal not be approved in the context of this proceeding. Under this Intervenor's proposal, it appears that marketers on Mich Con's system would benefit significantly from the pooling of nominations and imbalances, and would find it administratively easier for them to manage their assigned inventories, withdrawals, and injections in the aggregate (as opposed to being required to do so on a customer-by-customer basis). See, 3 Tr 343. In contrast, the pooling structure described by Constellation's witness could harm EUT customers by restricting their flexibility with regard to managing their gas supply within a particular month because each of them would apparently have to designate a single marketer to coordinate all of that month's service. In addition, Mich Con would be required to incur the cost of (1) restructuring numerous contracts with its EUT customers, (2) tracking various pools' activity, and (3) making all software coding changes necessary to allow its gas nomination and billing systems to function under the proposed pooling program. See, 5 Tr. 1255. Moreover, most--if not all--of those incremental costs would ultimately be borne by its ratepayers. The ALJ thus recommends that the Commission deny Constellation's request with regard to pooling.

6. Miscellaneous Tariff Revisions

In addition to the suggested revisions addressed above, the Company has proposed several other "miscellaneous or minor changes to its tariff pages under Section C of the Mich Con Rate Book." 5 Tr 1217. The six most substantial (or, at least potentially contentious) of these proposals were addressed by Staff witness McLean and are discussed on pages 44 through 48 of the Staff's initial brief.

Although fully supporting Mich Con's first proposal, which would expand the penalties for gas use during a curtailment period, the Staff asserts that the second proposed modification should be rejected in its entirety. Specifically, it contends that the Company's request to revise Section C5.1 to establish penalties for failure to allow reasonable access to a customer's premises is "unnecessarily punitive and unlike any other Michigan gas utility Access to Customer Premises tariff provisions." Staff's initial brief, p. 45 (citing 6 Tr 1777). As a result, Mr. McLean proposed that Mich Con be directed to modify Section C5.1 to read as follows:

> The Company's authorized agents shall have access to the customer's premises at all reasonable times to install, inspect, test, read, turn off, relocate, repair, or remove meters and other property of the Company

> situated on said premises, and to inspect and determine the load characteristics of appliances installed on said premises.

6 Tr 1778.

The ALJ agrees with the Staff with regard to both of these proposed tariff revisions. The curtailment penalties arising from Mich Con's proposed revision to Section C3.2, Paragraph J (as reflected on Exhibit A-13, Schedule F5.1, p. 14), are consistent with those currently used by Consumers, will better create adequate disincentives for the unauthorized use of gas during a curtailment period, and thus should be adopted by the Commission. As for Section C5.1, however, the ALJ finds that the Company's proposed language should be rejected as being overly punitive, and that the above-quoted language suggested by the Staff should be adopted instead (on the grounds that it is both more reasonable to ratepayers and more in keeping with the language used by other Michigan gas utilities).

With regard to the remaining four tariff revisions proposed by Mich Con, the Staff expresses general agreement with both the language and intent behind those proposals, but takes issue with either the specific level of charges that each would impose or the economic thresholds they would employ. Specifically, the Staff asserts that: (1) the fee established for requesting and receiving same-day gas turn-off service should be $75, as opposed to $90; (2) the charge for restoring service following a shutoff due to gas theft should only be increased to $50 for restoration during working hours, and to $75 for after-hours restoration, as opposed to the $65/$95 bifurcated charge the utility suggested; (3) the threshold for gaining access to a monthly payment plan for customer contributions toward construction should remain at $200, instead of increasing to $300; and (4) the connection fee should be left at $200 per meter for single-metered structures and $100 per meter for a multiple metered installation served from a single service line, as opposed to the Company's suggested levels of $300 and $150, respectively. See, 6 Tr 1779-1780. The Staff therefore argues that although each of these four tariff provisions should be revised as requested by Mich Con, the dollar values proposed for use by the Staff should be incorporated therein.

The ALJ agrees with the Staff concerning the first two tariff revisions, and recommends that they be approved, albeit with the use of the Staff's proposed level of charges (namely: $75 for same-day gas turn-off service, $50 for post-theft cut-off restoration during the workday, and $70 for such restoration if done after-hours). Nevertheless, the ALJ does not find the Staff's arguments persuasive with regard to the last pair of tariff revisions proposed by Mich Con. As noted by Mr. Fox, neither the threshold relating to customer contribution payment plans nor the utility's connection fee structure have been "adjusted since the 1995-96 period and should be adjusted to reflect updated values and costs." 5 Tr 1226. The ALJ finds that, in light of inflationary increases in employee-related costs likely experienced over the last 14 years, the Company's proposed $300 threshold and $300/$150 connection fee structure are reasonable and should be adopted. As a result, the ALJ recommends that Mich Con's proposed changes to Section C8.3 – Payment of Customer Contribution, and Section C8.4 – Connection Fee, both be approved by the Commission in the form in which they were initially written.

VIII.

MISCELLANEOUS ISSUES

In addition to those addressed above, three miscellaneous issues are deserving of specific mention in this PFD. The ALJ reaches this conclusion despite the fact that they were addressed by a relatively limited number of parties.

A. Pipeline and System Safety Concerns

In the course of this proceeding, the Staff offered detailed testimony from two of its gas safety engineers, David Chislea and Kristin Brock, on various safety issues relating to both (1) the condition of Mich Con's transmission and distribution system, and (2) the Company's efforts to remedy potentially dangerous situations.

Mr. Chislea testified that, largely because Mich Con's system contains an extensive amount of cast iron and unprotected steel gas main,[52] it has experienced--and likely will continue to experience--a significantly greater-than-average frequency of gas leaks when compared to similar-sized gas utilities. See, 6 Tr 1806-1813. Specifically, he noted that during 2008, Mich Con had 23.8 leaks per 100 miles of gas main, whereas Consumers only had 2.3 leaks per 100 miles. See, 6 Tr 1808. Mr. Chislea further indicated that at least part of this disparity can be attributed to the fact that Consumers had been much more diligent in replacing its metallic mains with more durable (and thus safer) pipelines. For example, he pointed out that between 1999 and 2008, Consumers replaced 5% of its system's metallic mains while Mich Con replaced only 1% of its own. See, 6 Tr 1809. With regard to cast iron mains alone, he continued,

[52] As noted by Mr. Chislea, gas pipelines such as these "are the most susceptible to leaks, failures, and incidents. 6 Tr 1813.

Consumers replaced 20% over that same 10-year period, whereas Mich Con only replaced 4%.

As for Ms. Brock, she testified that the number of Mich Con's pending leaks (which are defined as "leaks that have been identified, but not repaired") in southeast Michigan increased by 74.5%--from 3,624 to 6,851--between November of 2007 and August of 2009. 6 Tr 1821. While noting that "not all leaks require immediate remediation," she went on to state that "a high number of pending leaks indicates an increase in the probability of pipeline failure, which can result in the loss of both life and property." 6 Tr 1822. Ms. Brock further testified that Mich Con has several unresolved citations issued for various violations of the Michigan Gas Safety Standards (MGSS). According to her, the most recent pending non-compliances are:

1. Non-compliance 2008-02BM for MGSS Rule 192.465 entitled "External corrosion control: Monitoring;"
2. Non-compliance 2008-11BM for MGSS Rule 192.739 entitled "Pressure limiting and regulating stations: Inspection and testing" and associated Rule 192.749 entitled "Vault Maintenance;"
3. Non-compliance 2008-12BM for MGSS Rule 192.603 entitled "General Provisions" and associated Rule 192.605 entitled "Procedural manual for operations, maintenance, and emergencies;'
4. Non-compliance 2008-13BM for [MGSS] Rule 192.481 entitled "Atmospheric corrosion control: Monitoring" and associated Rule 192.479 entitled "Atmospheric corrosion control: General;"
5. Non-compliance 2009-KB for MGSS Rule 192.225 entitled "Welding Procedures" and associated Rule 192.241 entitled "Inspection and test of welds;" and
6. Non-compliance 2009-07JA for MGSS Rule 192-613 entitled "Continuing Surveillance" and associated Rule 192.723 entitled "Distribution system: Leakage surveys."

6 Tr 1836-1837. According to the Staff, the number and scope of these non-compliance citations reflects the Company's "growing difficulties with its metallic distribution and operating systems." Staff's initial brief, p. 59.

In light of the testimony provided by Mr. Chislea and Ms. Brock, the Staff claims that it "is greatly concerned about the Company's ability to provide safe and reliable service to its customers." Id., p. 56. Thus, in order to encourage Mich Con to remedy its system-related problems, the Staff recommends that:

> (1) The Commission require Mich Con to commit to spending an authorized capital expenditure amount to improve [its] natural gas system and file a report in each subsequent rate case analyzing the effectiveness of its capital expenditures in preventing leaks on its distribution system;
> (2) The Commission require Mich Con to file a leak backlog remediation plan with Staff, which develops a plan to systematically reduce the backlog of all leaks and allow the Company to timely repair newly found leaks. This plan should be updated semi-annually with Staff, demonstrating the progress made in reducing the leak backlog form one report to another. In each subsequent rate case, the Company should file the capital expenditures and progress made in reducing the backlog of leaks;
> (3) The Commission require Mich Con to file a plan with Staff detailing the actions the Company will take to eliminate the backlog of pending corrosion work orders and complete new corrosion remediation work, with semi-annual plan updates provided to the Staff. And in each subsequent rate case, Mich Con should file information pertaining to corrosion that demonstrates the dollars spent and the work performed. Further, Staff recommends Mich Con be required to incorporate their corrosion data into their Geographic Information System;
> (4) The Commission require Mich Con to dedicate sufficient resources to the main renewal program . . . [and] set out a long term plan to significantly reduce the amount of cast iron main in Mich Con's system. Staff further recommends that the Commission require Mich Con to file a separate docket detailing Mich Con's proposed main replacement program, which will provide the [Commission] the opportunity to review the planned program and set up a method to monitor Mich Con's implementation of the program; and
> (5) The Commission require Mich Con to develop a program to systematically move inside meters to outside locations, as was done for Consumers . . . in Case No. U-13156. In a new docket, Mich Con should be required to detail its proposed meter move out program, allowing the Commission the opportunity to review the planned program and set up a method to monitor its implementation.

Id., pp. 56-57 (citations omitted).

In response, the Company asserts that "it does not believe that separate dockets are necessary" with regard to either the cast iron replacement or the meter move-out programs "because Mich Con is making progress in both areas and will continue to work informally with the Staff." Mich Con's initial brief, p. 50. Nevertheless, it contends that if the Commission elects to establish separate dockets for those programs, each should include the following three elements: (1) an analysis of customer affordability and a determination of the appropriate size for these programs; (2) a review of the most appropriate method of financing and segregating these programs from other Mich Con capital spending; and (3) a Commission determination of the most appropriate way to recover the capital costs associated with the programs from Mich Con's customers. See, Id. Mich Con concludes by asserting that although separate dockets could be used to address issues and develop plans, the proper proceeding in which to "consider and determine recovery of the costs of implementing the plans" is a general rate case. Id. (citing 4 Tr 265-266).

The ALJ finds that, in light of evidence showing the sub-par condition of Mich Con's system, the lack of adequate progress in its improvement, and the danger posed by continuing down the same path followed by the Company over the last 10 years, the Commission should adopt the five above-mentioned recommendations posed by the Staff. Nevertheless, in light of the fact that the Staff did not object to them, and because their incorporation into the cast iron replacement and meter move-out dockets would appear to help shape each of those proceedings into a more functional vehicle for accomplishing its stated goal, the ALJ further recommends that the three elements suggested by Mich Con be included in both dockets.

B. Refund of Self-Implementation Overcollection

On January 1, 2010, and pursuant to Section 6a(1) of Act 286, Mich Con self-implemented rates designed to recover $170 million of its alleged revenue deficiency. As noted at the outset of this PFD, that increase was applied on an equal percentage basis for all customer classes.

The Staff notes that if the rate increase approved by the Commission's final order in this case is less than that which Mich Con self-implemented, Section 6a(1) also requires the Company to make an appropriate refund, with applicable interest, of the difference between what it charged and what the Commission's order ultimately allows. See, Staff's initial brief, pp. 72-73. The Staff therefore recommends that, if such an over-recovery is found to exist, the Commission should order Mich Con to issue a refund of that amount, plus all statutorily-mandated interest, to each customer class on an equal percentage basis. Id., p. 73. None of the parties object.

The ALJ finds that the Staff's recommendation is consistent with the provisions of Act 286 and should be adopted.

C. Proper Use of Rebuttal

Prior to the start of cross-examination on January 11, 2010, the ALJ considered and denied, in large part, several motions to strike filed by the Staff. See, 4 Tr 91-120. These motions pertained to rebuttal testimony filed on behalf of four of Mich Con's witnesses.

Despite indicating that it "has chosen not to continue to seek to strike [the] portions of the Company's objectionable rebuttal testimony," and conceding that it is "unable to meet the requirements" for an interlocutory appeal to the Commission, the

Staff included in its initial brief a request "that the Commission clarify the proper use of rebuttal testimony in rate case proceedings." Staff's initial brief, p. 75. Essentially, the Staff contends that the ALJ's rulings regarding what rebuttal would be allowed into the record established a test that is overly broad and not in keeping with the Commission's past treatment of such testimony.

Although asserting that "it is unclear what, if anything, [the] Staff wants the ALJ to do," Mich Con incorporated by reference its previously-filed responses to those motions as well as the oral arguments its counsel made on January 11, 2010, and states that it "supports the ALJ's decision." Mich Con's reply brief, p. 103. Moreover, the Company contends that the Staff's proposal to restrict the scope of rebuttal evidence "lacks merit and does not properly consider matters of context, prejudice, and practicality, as well as the ALJ's discretion and the importance of building a clear and complete record." Id.

Because the ALJ continues to believe that the rulings issued on January 11, 2010 were legally sound, consistent with the practicalities of this particular case, and adequately explained on the record, it is recommended that the Commission reject the Staff's request.

IX.

CONCLUSION

Based on the foregoing discussion, the ALJ recommends that the Commission issue an order adopting the findings and conclusions set forth in this PFD. These include findings to the effect that: (1) a projected 2010 test year should be adopted for use in this proceeding; (2) Mich Con's total rate base is $2,361,145,000, and consists of

$1,669,358,000 in net utility plant and a working capital allowance in the amount of $691,787,000; (3) the Company's overall rate of return should be 6.99%, including a cost of common equity of 10.50%; (4) the rates established in Mich Con's most recent rate case order would, if applied by the Company during 2010, give rise to a revenue deficiency of $142,888,000; and (5) the depreciation rates established for Mich Con as a result of the Commission's March 18, 2010 order in Case No. U-15699 should be factored into the rates established by the Commission's final order the present case, as indicated in footnote 28, supra.

Moreover, it should be noted that any of the parties' arguments not specifically addressed in this PFD were deemed to be irrelevant to the ALJ's ultimate findings and conclusions.

STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES
For the Michigan Public Service Commission

Mark E. Cummins

Digitally signed by Mark E. Cummins
DN: cn=Mark E. Cummins, c=US, email=mcummi@michigan.gov
Date: 2010.03.31 13:55:11 -04'00'

Mark E. Cummins
Administrative Law Judge

ISSUED AND SERVED: April 2, 2010